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Politics this week

Sep 28th 2006
From The Economist print edition

Shinzo Abe, who was confirmed as **Japan's** prime minister by the country's parliament, picked a cabinet. He also cut his pay by 30% as a symbolic gesture to help reduce Japan's huge public debt. See article

Getty Images

The presidents of **Afghanistan** and **Pakistan**, Hamid Karzai and Pervez Musharraf, held talks in Washington, DC, with George Bush. Tensions between both countries have increased lately with each blaming the other for the surge in Taliban violence, which was illuminated by a suicide-bomb in Afghanistan's southern Helmand province that killed 18 people. See article

The leaders of **Thailand's** military coup resurrected a dormant corruption commission so it could begin investigating the previous government. A week after tanks rolled onto the streets, the coup retained the support of most Thais. See article

Sri Lanka's navy said it had engaged Tamil rebels in a sea battle 80km (50 miles) off the strategic port of Trincomalee. The navy claimed to have killed 70 rebels in the encounter; the rebels said three.

Cause célèbre and effect?

George Bush released some parts of a classified report on trends in **global terrorism** after it was leaked to the press. The document stated that a number of factors were contributing to the spread of jihadist ideology, including the “cause célèbre”—as the authors called it—of the Iraq war. See article

As Congress prepared to adjourn ahead of November's elections, the White House reached a compromise with Republicans who opposed Mr Bush's plans for interrogating and trying **terrorism suspects**. But legislation that sought to settle the legality of Mr Bush's **wiretapping** programme was held up by differing versions of the bill.

The Republicans chose **Minneapolis-St Paul** as the site for their convention in 2008, an indication of how close the party thinks the presidential race in the Midwest will be. The Democrats are still considering whether to hold their jamboree in Denver or New York.

New Orleans held a party to celebrate the city football team's first game at the Louisiana Superdome since it was used to house evacuees from the flood that followed Hurricane Katrina.

Justice postponed

Saddam Hussein's chaotic trial in Baghdad was adjourned until October 9th. The defence lawyers had walked out after a change of chief judge, and Saddam himself was ejected from court three times in a week.

British forces in Iraq killed **Omar al-Farouq,** said to be a top lieutenant of Osama bin Laden. Captured in Indonesia in 2002, he escaped from an American military prison in Afghanistan last year.

AP

Israel freed Nasser al-Shaer, the Palestinian deputy prime minister, but about 30 **Hamas** politicians remain in custody.

An Israeli newspaper reported a secret meeting between a senior Saudi official

and Israel's prime minister, Ehud Olmert. **Saudi Arabia** has been trying to revive a 2002 Arab initiative calling for recognition of Israel in exchange for a Palestinian state along the 1967 borders.

Russia and Iran signed a deal over **Iran's nuclear reactor** at Bushehr, which they say should be fully operational in November 2007.

The latest report of a UN inquiry into the assassination of **Rafik Hariri**, a former Lebanese prime minister, confirmed that he was killed by a suicide bomber but did not elaborate on who was behind the attack.

Islamist forces captured the **Somali** seaport of Kismayo, strengthening their hold on the south of the country. See article

Let them in

The European Commission gave the go-ahead for **Bulgaria** and **Romania** to join the European Union next January. But it set tough conditions so as to monitor the two countries' progress towards EU standards. Most existing members will impose labour-market restrictions on Bulgarians and Romanians. See article

Tension rose between **Russia** and **Georgia** after the Georgians arrested four Russian officers in Tbilisi on spying charges. Russia demanded their immediate release.

Bertie Ahern, the **Irish prime minister**, admitted to receiving several large loans from friends when he was finance minister in the 1990s. Mr Ahern insisted he had broken no ethical, tax or legal codes, and said the lenders refused his offers to repay the money.

Tony Blair gave his final speech as prime minister to the annual Labour Party conference. It was well received, even by his enemies, easing pressure on him to step down sooner than next May's touted departure date. See article

A top **Bosnian Serb** leader, Momcilo Krajisnik, was given a 27-year jail sentence for war crimes by the UN tribunal in The Hague. Mr Krajisnik, who was once speaker of the Bosnian Serb parliament, was a close aide to Radovan Karadzic, who is still wanted on war-crimes charges.

A German opera company cancelled a production of Mozart's “Idomeneo” because it featured a severed head of **Muhammad**, among other religious leaders. The row over self-censorship for fear of Muslim extremism overshadowed an Islamic conference held by the government. See article

Coasting to a win

Final opinion polls before **Brazil's** presidential election suggested that Luiz Inácio Lula da Silva would win a second term, probably without the need for a run-off ballot. See article

The governor of the state of Oaxaca in southern **Mexico**, whose capital city has been brought almost to a halt by protests for four months, called for the dispatch of federal police to impose order. The protesters want the governor sacked as they claim he was fraudulently elected. See article

In **Guatemala**, seven prisoners died when 3,000 troops and police stormed a prison that had been controlled for more than a decade by inmates, some of whom produced drugs and ran businesses inside the jail.

AFP

Venezuela lodged a diplomatic protest after its foreign minister was briefly detained while about to catch a flight from Kennedy airport in New York. American officials apologised. They said the minister had bought a ticket with cash just 30 minutes before the flight and had refused extra security checks.

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Business this week

Sep 28th 2006
From The Economist print edition

The spotlight stayed on **Hewlett-Packard's** boardroom spying scandal as Congress prepared to grill company officials about the affair. The big question is how much Mark Hurd, HP's chief executive, knew about the methods used in an investigation to uncover a company leak? Mr Hurd is now chairman too: he took over when Patricia Dunn stepped down on September 22nd, soon after Mr Hurd gave his first public account of the shenanigans. Ms Dunn had intended to step down next January. See article

An American federal judge ruled that a claim filed in 2004 against **tobacco** companies, alleging that they misleadingly marketed "light" cigarettes as comparatively safe, could proceed as a class-action lawsuit. With the potential to include tens of millions of smokers, it is thought to be the country's largest class-action suit yet. The share price of big tobacco firms fell sharply. See article

It emerged that **Johnson & Johnson** is seeking $5.5 billion in damages from **Boston Scientific** and **Abbott Laboratories** for breaching J&J's 2004 merger agreement with **Guidant**, a maker of medical devices. J&J eventually lost a protracted bidding war for Guidant to Boston earlier this year. Abbott was also involved in the deal.

A Parisian love affair?

Rick Wagoner and Carlos Ghosn held talks in Paris about the mooted alliance between **General Motors**, **Renault** and **Nissan,** Renault's affiliate. It was the chief executives' first meeting since the idea was floated by Kirk Kerkorian, an investor who owns almost 10% of GM, in June. Since then, speculation has increased that GM would rather concentrate on its own restructuring plans, but both sides agreed to continue exploring the "potential opportunities" of a deal and report in the middle of October.

PSA Peugeot Citröen announced cost-saving measures that include the loss of 10,000 jobs, or 7% of its European workforce. Europe's second-biggest carmaker is suffering from an erosion of its market position, attributed to the staleness of its models.

Aer Lingus priced its initial public offering towards the lower range of expectations, valuing the Irish state-owned carrier at *euro*1.13 billion ($1.4 billion) when it starts trading next week. The flotation is regarded as a gauge of investors' appetite for airline shares after recent security scares—Aer Lingus will be the first airline to make its debut on the London Stock Exchange since easyJet in 2000.

Jacob "Kobi" Alexander was arrested in Namibia, several weeks after he went on the run to escape charges in a stock-option scandal stemming from when he was chief executive of Comverse. American regulators are to ask for the extradition of Mr Alexander, whose flight initiated a global manhunt and numerous alleged sightings.

Andrew Fastow received a six-year prison sentence for the part he played in Enron's collapse. The energy-trading company's former chief financial officer had agreed to a ten-year term as part of a plea bargain, but the judge reduced this because of the "exceptional" help Mr Fastow had given to the prosecution.

Dragging E.ON and on

Germany's **E.ON** raised its bid for **Endesa** by almost 40%, valuing a merger with the Spanish utility at around *euro*37 billion ($47 billion). E.ON acted after learning that Acciona, a Spanish construction group, had taken a 10% stake in Endesa, putting a further potential obstacle in the German company's path. Spain's government was criticised by the European Commission this week for its attempts to block the

cross-border acquisition.

The battle for Endesa was not the only Spanish utility deal to excite investors. **ACS**, a Spanish building firm, bought a 6.3% stake, worth *euro*2.1 billion ($2.7 billion), in **Iberdrola**, the country's second-biggest power company. ACS also dampened speculation that it was trying to pursue a merger with **Union Fenosa**, a utility of which it is the controlling shareholder, and displace Endesa as Spain's biggest utility.

Consolidation among European drug companies continued apace as **UCB** reached an agreement to buy **Schwarz Pharma** for *euro*4.4 billion ($5.6 billion). The announcement came four days after **Merck** unveiled its acquisition plans for **Serono**, and **Altana** said it would sell its pharmaceutical business to **Nycomed**. See article

The **price of oil** briefly dipped below $60 a barrel for the first time since March. See article

Happy talk

American **consumer confidence** rebounded in September from August's sharp fall (the news was one element pushing the Dow Jones Industrial Average towards a new high). Cheaper petrol prices were said to be the main factor fuelling the optimism.

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Brazil's presidential election

Who leads Latin America?

Sep 28th 2006
From The Economist print edition

A champion of Brazil's poor, Lula has lost ground to corruption, economic torpor and his Venezuelan rival

AFP

Get article background

FOUR years ago, when he was elected Brazil's president by a landslide, Luiz Inácio Lula da Silva seemed destined to become the spokesman for a new, more confident and more socially just Latin America. Not only does Brazil, the world's fourth-largest democracy, have legitimate aspirations to regional leadership and to a bigger role in the world. Mr da Silva's own life story—the seventh child of a dirt-poor family from the north-eastern backlands who rose to become a trade-union leader—entitled him to assume the moral leadership of a new, democratic Latin American left, one that seemed to have freed itself from the past attachment to an all-powerful state. Four years on, Lula (as Mr da Silva is universally known) seems almost certain to win a second term, either in a general election on October 1st or in a run-off ballot a month later. Sadly, however, he has lost some of his lustre.

His is not the loudest voice coming out of Latin America, nor even of its left. That belongs to Hugo Chávez, Venezuela's populist president. On September 20th, in a speech to the United Nations General Assembly, Mr Chávez trumped even Iran's Mahmoud Ahmadinejad in the adolescent stridency of his anti-Americanism, referring to George Bush as “the devil”. Loudness is not necessarily persuasive. But Mr Chávez is a cunning communicator who commands a deep well of oil money. He has dispensed largesse from Argentina to Africa (see article), and hopes that this will win Venezuela one of the two rotating seats for Latin America on the UN Security Council. For this he has secured the additional support of Russia and China, as well as that of a bunch of dictators from Belarus to North Korea.

Latin America's democracies have legitimate quarrels with Mr Bush and the United States. But it is hard to see how their interests will be effectively represented by Mr Chávez, an elected autocrat with a habit of trying to wreck any grouping he is unable to control. What is truly odd is that Venezuela's UN candidacy has the backing of Brazil. Lula is thus helping to offer his chief rival for leadership in South America a global platform. His view is that the best way to contain Mr Chávez is to include him, in the Mercosur trade group for example. This looks shortsightedly self-serving: it is a sop from Lula to his party's left-wing, which disagrees with his economic policies. And Mr Chávez's response? To help to humiliate Brazil in Bolivia, where Petrobras's oil and gas assets face nationalisation, and to work to undermine the democratic, free-market principles on which Brazil founded Mercosur.

Apart from the naivety of Lula's foreign policy in South America, there are two graver reasons why

Brazil's president has lost his shine. One is that he has presided over a worsening of political corruption in Brazil. Last year, it emerged that several of his closest aides had orchestrated a scheme under which a score of legislators from allied parties were paid cash in return for their votes in Congress. This month, a new scandal erupted: members of Lula's campaign team quit after arranging to pay for and publish documents smearing opponents by linking them to a different corruption scheme. To cap it all, Antonio Palocci, Lula's effective finance minister for much of his first term and perhaps his future party leader in Congress, may face charges over yet another scam.

The economy is a further disappointment. Lula and Mr Palocci sensibly steered clear of debt default and stuck to responsible macroeconomic policies. But Brazil's economy has only crept along, growing by an average of just 2.8% a year under Lula. Swelling tax revenues, rather than smarter spending, have kept the fiscal accounts under control. Investment is restrained by red tape, poor infrastructure and regulatory uncertainty, as well as by the crippling tax burden on business.

It is all the more remarkable, then, that Lula is heading for a second term that in many ways seems unwarranted. Most Brazilians long ago concluded that their country's politicians are irredeemably corrupt. But many identify in Lula one of their own, and do not see him as having benefited personally from graft. Above all, the secret of Lula's electoral success is that he has kept his promise to help poorer Brazilians (see article). Thanks to a successful anti-poverty programme that channels small cash payments to 11m families, to low inflation, wider access to education and big increases in the minimum wage, the incomes of the poor are rising much faster than those of the middle class. The result is that in a country notorious for its inequalities, income is more equally distributed today than at any time in the past 30 years.

How to restore the lustre

Some of Lula's achievements owe much to his predecessor, Fernando Henrique Cardoso (as does the bad habit of tax-and-spend). Brazil's ways of helping the poor look more effective, sustainable and democratic than those of Mr Chávez, who relies on showers of oil money and Cuban advisers. But continued progress will require different policies, as Lula sometimes seems to recognise. In a second term, he should make a concerted effort to pry Brazil free from its low-growth trap. That will require cuts in tax, the federal bureaucracy and wasteful government spending, as well as reforms of pensions, regulatory agencies, education and the labour market. And it will be difficult. Lula's own party resists such measures, and he may be even more at the mercy of his Congressional allies' voracious appetite for public money. To pass the needed reforms, he may need to appeal to the opposition.

Brazil is often bracketed with China, India and Russia as one of the world's emerging economic powers. When it comes to economic growth, that is to flatter it. (It is also misleading: Brazil had a growth spurt from the 1950s to the 1970s, and is now a middle-income country in which sustaining rapid growth is harder.) If its economy were expanding by 5% or 6% a year, Brazil's claim to regional leadership would carry greater weight. And if Lula took serious steps to clean up Brazilian politics—by pushing for more accountable party and electoral systems—he would start to restore his own claims to moral leadership of the region's left. That is something from which both Brazil and Latin America would benefit.

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British politics

Who is David Cameron?

Sep 28th 2006
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What the Conservatives' bright new hope can learn from Gordon Brown

THE new Conservative leader, David Cameron, goes to his first conference with the best ratings his party has had for 20 years. Most polls say that his lead will widen if, as seems likely, Gordon Brown, the chancellor, takes over from Tony Blair as Labour leader. Even on issues on which Labour has traditionally been strong, such as health and education, the Conservatives are now ahead, despite the fact that Mr Cameron has no discernible policies on either.

This must be gratifying for him, for it vindicates the strategy he set out when running for the leadership a year ago. Voters, he argued, were so hostile to the party that they disliked and disbelieved anything it proposed. Unless people could be persuaded that the Tories were decent and well-meaning, they would continue to regard the party with a deadly mixture of indifference and contempt.

Cuddly conservatism

Mr Cameron has tried to change voters' attitudes by taking swipes at carefully chosen targets. The Conservatives are seen as too close to business? Attack shops selling provocative clothes for children and call for corporate social responsibility. Self-interested? Go to the North Pole and fret about global warming, preferably in the company of a furry animal. Too authoritarian? Suggest that louts need love and understanding. Stick to warm slogans such as “trusting people” and “modern compassionate conservatism”, and hope that the electorate's growing disillusionment with a fractious government that has been in power for nearly a decade would do the rest. Intellectually vacuous, perhaps; but also politically successful.

However, transforming the Tory image from selfish and mean to cuddly and green is not enough. Successful oppositions do not just wait for governments to collapse. They accelerate the process by showing that they are ready to take over. Mr Blair did this when he won the Labour leadership in 1994, and the contrast between him and the exhausted Tories created the conditions for Labour's landslide in 1997. This does not mean Mr Cameron should set out now precisely how much a Tory government would tax and spend in 2010, or provide a detailed blueprint of how it would run the health service. What he must do, though, is define a clear philosophy and identity that will give voters a sense of what they are voting for and help shape Conservative policies. He also has to persuade voters that he leads a confident and united party.

And he should move soon. By next summer, Labour will have a new leader. Until then, the government will be drifting and wrapped up in its own affairs. Mr Blair will have little authority and Mr Brown will have to wait as patiently as he can before attempting the difficult task of renewal in office. Mr Cameron, meanwhile, can use his husky-hugging popularity to get his way against opponents within his party. This opportunity will not last long. Mr Cameron's moment is now.

He needs to do three things. First, he must sketch out his ideas about what government should and should not do. Like most Tories, he seems to believe instinctively in a smaller state; but since public finances will be tight for the next three years, pledging tax cuts would be unrealistic. However, a Conservative Party that is content with public spending running at 42% of GDP is not doing its job. Mr Cameron should make it clear that his long-term aim is to see government intrude less in people's lives and take less out of their pay packets.

One way to make the state do less is to hand the job of delivering more public services to providers from the private and voluntary sectors. Mr Blair has tried to occupy this ground, but since Mr Brown seems less comfortable on it, Mr Cameron should try to make it his own. There is no reason why this approach should look conventionally right-wing. Mr Cameron should explain that such changes would give choice and power to people who currently have very little of either. Mr Blair, of course, has done that over and over again; but so what? As Labour's espousal of market economics has shown, stealing the other party's clothes can be a successful strategy.

Second, Mr Cameron needs to follow up on his intention of making his party, once a club of (near-) dead white males, look as though it represents modern Britain. That means pushing through organisational changes and tightening his grip on how the party chooses its parliamentary candidates.

Third, he should use the limited opportunities that the leader of the opposition has to dabble in foreign affairs to appear more statesmanlike than he has so far. He has already had to postpone his plan to pull out of the centre-right European People's Party in Brussels. This pledge might have seemed a good tactic to win the affections of the party's Eurosceptics. But he has found it impossible to deliver, and his dithering has irritated those he was trying to please almost as much as those who thought it a bad idea to start with. Mr Cameron should ditch his pledge altogether and acknowledge that the best way to exercise influence in Europe is from within its biggest political group, rather than from the fringes.

Opposites detract

He needs to counter the perception on the other side of the Atlantic that he is anti-American. The fifth anniversary of September 11th was the wrong moment to make a speech criticising Mr Blair's close relationship with the White House. Even though Mr Cameron spent part of the speech attacking anti-Americanism, he appeared to be trying to profit from Mr Blair's unpopular stance. An uncomfortable sense that he was moving in the wrong direction may be one reason why he has persuaded John McCain, a Republican front-runner for the American presidency, to address next week's conference.

If Gordon Brown and David Cameron face each other as party leaders, it will be a curious match, for they are, at present, opposites. Mr Brown is all substance and, sadly for his polling figures, no style. Mr Cameron is, so far, all style and not enough substance. If he can acquire a little of the dour Scotsman's intellectual seriousness, he will be a real contender at the next election. And that, for Britain, would be great: competition, as this paper occasionally points out, is a fine thing.

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Japan

Assertive Abe

Sep 28th 2006
From The Economist print edition

The new prime minister of Japan has to win trust at home and abroad

AP

THE man who became Japan's leader this week is, at 52, the country's youngest prime minister since the second world war, and the first to have been born after it. His inexperience and his so far largely unarticulated intentions leave everyone guessing. If there is a prevailing opinion, it is that Mr Abe will not have the flair, the authority, or perhaps even the gumption to carry forward the structural improvements to Japan's economy wrought by his unconventional predecessor, Junichiro Koizumi. What authority Mr Abe can muster, it is suggested, will dwindle as defeat looms for his ruling Liberal Democratic Party (LDP) in next July's elections for the upper house. So it is feared that Mr Abe, a hardliner by instinct, will try to distract voters from a dismal domestic record by gratuitous nationalistic provocation of China, and South and North Korea. When they snarl in their different ways, he will scuttle back under America's skirts.

All possible, certainly. But there is a more hopeful prospect: that Mr Abe, representing a generational change, pushes forward reforms at home and reaches for a bigger role abroad, while undoing the damage to Japan's relations with its neighbours caused by Mr Koizumi's stubborn visits to Tokyo's Yasukuni shrine, a symbol of Japan's past militarism. Mr Abe was due to lay out his priorities to parliament on September 29th, after *The Economist* went to press. But the government line-up that he announced on September 26th (see article) hints that it is this second path that Mr Abe hopes to take.

In traditional fashion, Mr Abe has rewarded older politicians and party factions that early on backed his rise to power. But he has also appointed eager and youngish reformers to key cabinet posts. In foreign policy, he looks like relying on fellow conservatives like himself, but ones with a practical streak—notably Taro Aso, who stays on as foreign minister.

How to revive an ageing economy

Though Mr Abe inherits an economy that has grown for four consecutive financial years, that luck cannot last forever. Japan needs stronger foundations for growth, but they can be laid only by taking on powerful interests. Despite huge changes to the economy, some sectors—including some in manufacturing and much in services—remain largely unreconstructed. Foreign capital would do much to create prosperity and jobs. So Mr Abe needs to improve the climate for investment, including making it easier for foreigners—as well as locals—to acquire Japanese companies.

Growth, and a definitive end to long years of deflation, would bring the exchequer fresh revenues. But with an ageing and shrinking population this would not be enough to plug the budget deficit and bring down Japan's scary levels of national debt. The caps on annual government borrowing and cuts to government projects, both introduced under Mr Koizumi, must therefore continue, and there is much scope still for privatisation. But, unavoidably, taxes must also go up. Mr Abe has studiously suppressed a debate about raising the consumption tax. Even with elections next year, he must start talking about it, in the context of broader fiscal reform that encourages investment and helps people find work. Hardest of all, he needs to tackle the health and social-security costs that eat up so much of the budget. This means challenging powerful medical and pharmaceutical interests, as well as explaining to those who can afford it that they must pay more for benefits. The prize will be a perkier, more resilient economy.

Drawing Yasukuni's sting

Both at home and abroad, Mr Abe will have to put the case better than others have done for Japan's legitimate desire to play a bigger—more “normal”—role in the world. Long held back not just by a pacifist-sounding constitution, but also by a lack of imagination, Japan under Mr Koizumi made commendable moves towards a more muscular and constructive diplomacy that better matched its economic clout. Its naval supply ships have helped in the battle to defeat the Taliban in Afghanistan. It sent peacekeepers to Iraq. And, unprecedentedly, it took the diplomatic initiative in responding to North Korea's missile tests in July, winning a toughly worded UN resolution that eventually had China's support.

Mr Abe wants to go further. He would like to loosen Japan's constraints on “collective” self-defence that prevent both joint military exercises and the defence of allies under fire. Ultimately he wants to revise the pacifist constitution. These are desirable goals, yet they arouse deep suspicions among neighbours—notably China and South Korea. Only last year, China scuppered Japan's bid for a permanent seat on the UN Security Council. And bad relations between the two make it harder to draw China in as a “responsible stakeholder” in East Asia and beyond. On relations with South Korea, the signs are promising. Mr Abe and President Roh Moo-Hyun have agreed to meet. But the most important move that Mr Abe could make to help reconcile his foreign-policy ambitions with the neighbours' suspicions is to avoid visiting Yasukuni.

Given the right signal, China would jump at the chance to resume top-level summits that were suspended with Mr Koizumi. South Korea also says it wants a more “forward-looking” relationship with Japan. Drawing the Yasukuni sting (later a way needs to be found to honour Japan's war dead but not the 14 “Class A” war criminals also enshrined there) will even help with Mr Abe's next priority: strengthening Japan's security alliance with America, which would like to see Japan's relationship with China improve. Meanwhile, Mr Abe could better explain to Japanese voters the benefits of the alliance with America—something Mr Koizumi was not always ready to do. And he needs to add an economic dimension, perhaps by floating the idea of a free-trade agreement, such as the one America is pursuing with South Korea.

Mr Koizumi's decisions to visit Yasukuni seem to have been emotional. Mr Abe, a regular up to now, is a more pragmatic character. He has not yet signalled what he plans to do; but a cool assessment of both his and his country's interests would argue for staying away from the shrine.

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China

The harder they fall

Sep 28th 2006
From The Economist print edition

What the firing of Shanghai's party boss says about China

Eyepress

Get article background

ABROAD, China likes to portray itself as a responsible power to be reckoned with. But at home its Communist Party is still a law unto itself. As Shanghai's once-powerful party boss, Chen Liangyu, is now experiencing for himself, party investigators have the power to detain members suspected of wrongdoing indefinitely, with no access to lawyers. The party will decide whether to forgive any sins that have been committed, or hand over the accused to the police. The verdict will be reached in utter secrecy.

Such is the spine-chilling world in which Mr Chen, until last week in charge of China's showcase of modernity, now finds himself (see article). He is accused of involvement in the misuse of $400m of Shanghai's pension fund, of helping relatives in criminal ventures and of covering up law-breaking by aides. But his political demise is about more than alleged sleaze. In power struggles at the top of the Chinese leadership, charges of corruption are often a convenient weapon. Meanwhile, corruption is made worse by the party's handling of China's fast-changing economy.

Getting the wrong sort of grip

President Hu Jintao is fighting to impose his authority on wayward localities which are defying efforts to rein in economic growth and prevent a frenzy of ill-considered investment that could further cripple the banking system with bad loans. Before a five yearly party congress late next year, Mr Hu also wants to install loyalists in key posts in the provinces. Mr Chen owed his job in Shanghai to Mr Hu's predecessor, Jiang Zemin, making him an obvious target. He is also widely rumoured to have attacked Mr Hu's economic-control measures at a meeting of the ruling Politburo two years ago.

By taking on Mr Chen—the first Politburo member to be dismissed in more than decade—Mr Hu is flexing his muscles. But he is also showing how little the party has changed. When he first came to power in 2002, he seemed to signal that he would make the party more open and subject to the rule of law. Instead, its investigations are still driven by politics. Corruption is just as rife. The 200-member Central Committee is supposed to monitor the work of the 24-member Politburo headed by Mr Hu, but at its annual meeting next month it will rubber-stamp whatever is put before it.

Mr Hu's difficulties in taming the economy—it grew by 11.3% year-on-year from April to June, its fastest quarterly rate in more than a decade—show how far the party has yet to go in embracing market mechanisms. It far prefers to manage by administrative fiat—issuing orders to clamp down on this or that type of investment—rather than allow interest or exchange rates to do the job. That encourages local officials to beg for special favours. More than 5,000 localities from provincial down to county level have opened offices in Beijing in recent years, spending some $2.5 billion annually on lobbying, according to China's media—and fuelling corruption.

Shanghai has prospered on Mr Chen's watch. He helped it win the right to host the World Expo in 2010. But Shanghai's citizens will not mourn his fall. There is deep cynicism in Shanghai and the rest of China about the probity of party officials. There is also great scepticism that the party can do anything about it. By lashing out at Mr Chen, while resolutely eschewing a free press, an independent judiciary and competitive elections, Mr Hu does nothing to reassure.

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The European Union

In praise of enlargement

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From The Economist print edition

Don't put new obstacles in the way of expanding the EU

Get article background

THERE is no clear answer to the question of how far east Europe stretches. But Romania and Bulgaria are European by any definition. So this week's news that these two Balkan countries are to join the European Union next January ought to be welcomed. Yet it was greeted with dismay in some European capitals—and with a warning by the president of the European Commission, no less, that the club cannot take in more members without reforming its institutions. This is code for demands to revive some or all of the ill-fated EU constitution that was rejected last year by French and Dutch voters.

Such a sullen response is testimony, say Europe's *cognoscenti*, to "enlargement fatigue". Even in Brussels the talk these days is of limits to the club's "absorption capacity". Yet polls still show a narrow majority of Europeans in favour of taking in more countries. The most recent expansion, the big bang of May 2004, when eight ex-communist countries (plus Cyprus and Malta) joined, has been highly successful. The growth in size of the EU has given it extra political clout, brought stability and prosperity to new members—and yielded tangible benefits for existing ones.

This is not to dismiss doubts over the readiness of the two newcomers. There are grounds for concern over organised crime and corruption, especially in Bulgaria. Under pressure from Brussels, however, matters have improved in the past year. It is true that leverage over would-be EU members is greater before they join than after. But for Romania and Bulgaria, at least, the pressure will continue via the safeguard clauses that the commission is putting in place (see article).

It is also true that the political scene across central Europe is not pretty. Slovakia has a sleazy and thuggish new government. Hungary's prime minister has provoked riots by lying about the economy. Poland's populist coalition is tottering. The Czechs have given up trying to produce any government at all. Everywhere much-needed reforms have slowed or stopped. Contemplating all this, it is not surprising that some ask if it was right to let even these countries in.

The shock of the new

Yet in the sweep of EU history, these are mere teething troubles in a growing-up period. Plenty of older EU members suffer from organised crime and corruption, and have had bad or unstable governments. It is also older EU countries that have been most reluctant to reform their economies; as a result, they have been suffering from a virulent attack of slow growth. Most new EU members have fast-growing economies that have lifted the performance of the whole continent.

Labour migration, contrary to some fears, has also been beneficial. A commission report showed that the three countries (Britain, Ireland and Sweden) that let in workers from the east in 2004 all gained. Labour mobility is not a zero-sum game: both senders and recipients win, as new jobs are created. Labour markets will be fully opened to Romania and Bulgaria within seven years; travel restrictions will go sooner. Better to welcome the new workers now, rather than imposing restrictions that most EU members (even Britain) are now planning in a bid to appease the populist press.

Old Europe has gained immeasurably from improved stability on its borders. As happened with Greece,

Spain and Portugal in the 1980s, joining the EU club has helped entrench democracy, the rule of law and economic growth in countries that for too long had none of these things. Similar considerations should govern the EU's approach to other would-be members. EU governments know that the security and stability of the western Balkans depends on holding out to countries in the region the promise of joining their club one day. That prospect is essential to keeping a wavering Turkey on its pro-western path, too (see article). This grander vision is what Europe's leaders should be describing to their voters—not making future expansion of the club dependent on an internal quarrel over its constitution.

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The war on terror

That winning delusion

Sep 28th 2006
From The Economist print edition

An intelligence report suggests America must try harder in Iraq if terrorists are to be quelled

AP

THE release of parts of a weighty assessment of global terrorism this week confirms a depressing truth: George Bush is not, as he often claims, winning the war on terrorism, he is losing it (see article). Further, the main conclusions of the national intelligence estimate, which was completed by the 16 American intelligence agencies last April, suggest that Mr Bush is worryingly deluded. Jihadist terrorists are multiplying steadily in an increasing number of places. A key reason for this, the report says, is the debacle caused by America's invasion of Iraq—which is described as a “cause célèbre” for jihadists. These conclusions were leaked, accurately as it turns out, to the *New York Times*. Yet Mr Bush took the unusual, and baffling, step of releasing the text from which the leaks were drawn partly to face down the newspaper's claims. Instead of vindicating his prosecution of the war, the assessment is a dreadful indictment of it.

A little more hopefully, the intelligence estimate says that an American success in Iraq would be a demoralising blow for the jihadists. In his refusal to countenance failure there, Mr Bush seems to have understood this imperative. He is also showing—in an election year, with the war increasingly unpopular in America—an impressive resolution. But it is not clear that he is prepared to pay for his war. On September 20th, America's top general in the Middle East predicted that, contrary to the administration's predictions, American troop levels in Iraq would remain at their current level, around 140,000, well into next year. That figure does not represent the number needed to pacify Iraq, but the maximum number that can easily be dispatched there. Donald Rumsfeld, the defence secretary, has sorely limited the number of American troops in Iraq and Afghanistan. But to succeed, as Iraq's security forces continue to disappoint and sectarian killing mounts, America needs to send more.

How many more, and for how long, must be for the generals to decide. Wherever American troop numbers have been increased in Iraq, security has been improved, at least for a while. At the same time, it is vital that any increase be kept to a minimum. Three and a half years since the invasion American troops remain brutal peacekeepers, winning few friends with their trigger-happy ways. And the strategy of pushing Iraqi forces to take responsibility for their country is sound. But at least one additional American division, around 20,000 men, is needed in western Iraq, according to the leaked estimate of the American commander there. A similar number are probably required in Baghdad, where last month reinforcements of 12,000 American and Iraqi soldiers had small success in taming the madness.

Finding these extra troops will be difficult and costly. Even to maintain its current numbers in Iraq,

America must break yet more promises to its over-stretched soldiers. It will have to extend combat tours, shorten the intervals between them and perhaps, as a last resort, increase the stipulated 24 months for which the National Guard and the reserves may be deployed. Meanwhile, to ease the strain, it should increase the army's authorised size by at least 30,000 soldiers, the number temporarily added to the force by Congress earlier in the war. With luck, by the time those troops are ready, they will not have to be sent to Iraq or Afghanistan. But they will still be needed. America aims to be able to fight two wars and several smaller operations simultaneously. On current form, it clearly cannot.

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On climate change, Bretton Woods, the Pope's speech

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From Economist.com

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A hot topic

SIR – One of the reasons the discussion of climate change is so frustrating is the continued dissemination of a basic error (A survey of climate change, September 9th). Your statement that "The Gulf Stream is driven both by the rotation of the Earth and by a deep-water current called the Thermohaline Circulation" is false. The Gulf Stream is a wind-driven phenomenon (as explained in a famous 1948 paper by Henry Stommel). It is part of a current system forced by the torque exerted on the ocean by the wind field. Heating and cooling affect its temperature and other properties, but not its basic existence or structure. As long as the sun heats the Earth and the Earth spins, so that we have winds, there will be a Gulf Stream (and a Kuroshio in the Pacific, an Agulhas in the Indian Ocean, etc).

Shut-off would imply repeal of the law of conservation of angular momentum. The primary mechanism of heat transport in the ocean is the wind-forcing of currents that tend to push warm water toward the poles, cold water toward the equator. Widely disseminated and grossly oversimplified pictures showing the ocean as a "conveyor belt" have misled people into thinking ocean circulation is driven by a sinking motion at high latitudes. A comprehensive literature shows that with no wind, heating and cooling could produce a weak flow, but one not at all resembling the observed circulation.

If the sinking motion at high latitudes were completely stopped, by covering that part of the ocean by sea ice for instance, there would still be a Gulf Stream to the south, and maybe an even more powerful one as the wind field would probably then become stronger. If the sinking were stopped by adding fresh water (a deus ex machina often invoked to change the climate), the Gulf Stream would hardly care except in so far as the wind system changed too. The amount of heat transported by the system would shift, but could not become zero.

Many writers, including scientists, toss around the words "Thermohaline Circulation" as though they constituted an explanation. In the ocean, most of the movement of heat and salt, the real Thermohaline Circulation, is driven directly and indirectly by the wind field. Thus the Gulf Stream, and hence the wind, rather than being minor features of oceanic climate are best regarded as the primary elements. Many real climate change effects exist and require urgent attention; focusing on near-impossible Gulf Stream failure is an unproductive distraction.

Carl Wunsch
Cecil and Ida Green Professor of Physical Oceanography
Massachusetts Institute of Technology
Cambridge, Massachusetts

SIR – You rightly pointed out that politics is the biggest impediment to any meaningful collective action on tackling climate change. This is as true today as it was in 1997 when I was the lead American negotiator on the Kyoto protocol. However, one area provides a key opportunity for a way out of the political impasse: forestry. As you noted, deforestation is the second-largest source of anthropogenic greenhouse-gas emissions, accounting for some 18% of the world's total; yet forestry has been entirely left out of policy equations. This makes no sense.

For example, expanded credits for forestry-based offsets, including reforestation, afforestation and avoided deforestation, would give the rural poor a critical source of income to manage and sustain their landscapes. Such credits would also provide incentives to developing countries to consider binding commitments under any future international regime.

This approach would give a much needed boost to America's re-engagement on the issue. Companies striving to meet their emissions targets would benefit from additional flexibility and farm communities could be mobilised to support long overdue action to address the problem.

Stuart Eizenstat
Washington, DC

SIR – Canada may well be in a similar situation to Japan in that its emissions are almost a quarter above its 1990 levels even though it has a target to reduce them by 6%. Yet since its election eight months ago, Canada's Conservative government has done nothing about the problem, other than scrapping a plan from the previous government. While many believe that it is still possible to meet the targets if a serious enough effort were engaged immediately, this is getting less possible with each passing day. The government has explicitly ruled out buying credits in the carbon market from abroad, which is the only way to meet Canada's legally binding commitments under the Kyoto protocol if it fails to meet its targets. Thus, Canada appears to be the only country in the world that has announced its refusal to respect its commitments under Kyoto, apparently in the belief that its sanctions have no bite.

Philip Raphals
Executive director
Helios Centre
Montreal

SIR – You provided a welcome voice of reason on climate change. However, it is a myth that transport is not a major part of the problem because it accounts for "only 13.5% of emissions" in the world. In a developed country like Britain transport is responsible for about one-third of emissions and this is rising, mostly because of aviation. The pattern of transport emissions in developing countries are different now, but they are clearly becoming more like us. The problem is the potentially explosive growth in demand for transport worldwide and the relative paucity of obvious technological fixes.

John Rhys
London

SIR – Yes, America is the largest producer of greenhouse gases, but it is also, with its expansive forests and grasslands, one of the largest absorbers of greenhouse gases. When the prevailing westerlies come in from the Pacific they have a higher CO_2 content than when they leave over the Atlantic: a "carbon sink" effect. Europeans should be thankful that we are sending this cleansed air off to them. Contrast this with the air we receive. If one visits Mount Hood in Oregon one can see that the snow on the side of the mountain facing China has a grey shade while the east side is bright white. What is needed is not more Kyotos where big polluters get off scot-free, but a push for democracy and a greater say about the environment.

James Brenzel
Menlo Park, California

SIR – The Earth has two hemispheres. So when you said that: "The bottom end of the range [of average temperature increases] would make life a little more comfortable for northern areas and a little less pleasant for southern ones" ("The heat is on", September 9th), what I think you meant is that if temperatures rise, life would be a little more comfortable in the polar areas and a little less pleasant in the equatorial ones.

Alejandro Meza
Santiago, Chile

SIR – In 1997 you mocked global warming as "the mother of all environmental scares" and asserted that people who "peddle ecological catastrophes" were "invariably wrong" ("Plenty of gloom", December 20th 1997). Did someone mention Al Gore? Good work with your recent survey, but you still have a lot of making up to do.

Yoram Bauman
Seattle

Alive and well

SIR - You are wrong to suggest that Raymond Mikesell was “the last surviving economist present at the conference in 1944 at Bretton Woods” (“Turning grey”, September 19th). Jacques Polak, who was a member of the Netherlands delegation at Bretton Woods, is very much alive and active at the age of 92. Mr Polak lives in Washington, DC, plays tennis regularly and maintains an office at the IMF where he continues to write. The latest volume of his collected papers, “Economic Theory and Financial Policy: Selected Essays of Jacques J. Polak 1994-2004,” was published by M.E. Sharpe in 2005.

James Boughton
IMF historian
Washington, DC

Don't protest too much

SIR - The pope makes a speech insinuating a link between Islam and violence, and Islamic militants in Somalia respond by shooting dead a 70-year-old nun outside a children’s hospital (“Stirring up anger”, September 18th). The irony is impossible to ignore. I eagerly await the day that Muslims around the world flock to protest against the killing of innocent people by Islamic militants.

Nicole George
Phoenix, Arizona

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Brazil

Love Lula if you're poor, worry if you're not

Sep 28th 2006 | CONTAGEM
From The Economist print edition

AP

The voters in Brazil's elections on October 1st can look back on welcome help for the dispossessed and forward to the likelihood of little broader reform

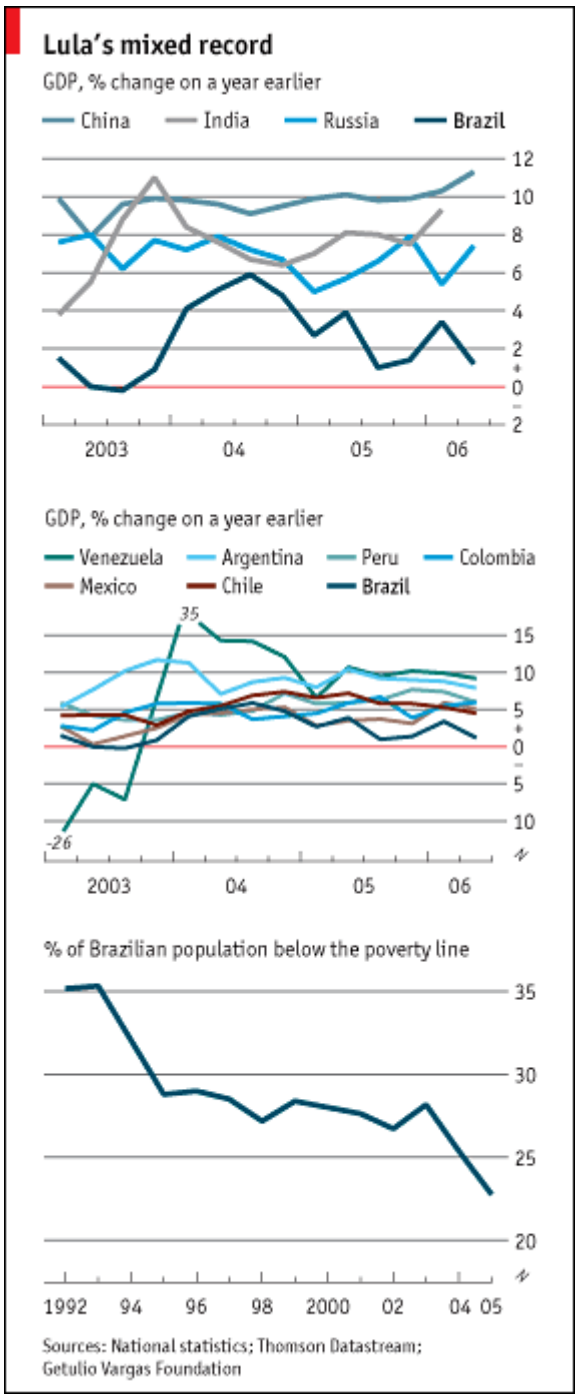
Get article background

AN UNEXPECTED whiff of garlic is the first indication of an industry that helps sustain the 70,000 people of one of the poorer districts of Contagem, a city in eastern Brazil. Elizabete Cordeiro and Romilda da Silva are among the 200 women who spend their days peeling garlic, which fetches more than the unshelled sort in nearby Belo Horizonte. Hunched over plastic buckets outside a brick hovel, they shell 1,000 kilos a month. This yields 400 reais ($185), which they share.

Hard as life is, it has lately improved. Shelling garlic pays more than it did, thanks to a one-third rise negotiated by a local NGO. And a few months ago the women became beneficiaries of the federal government's Family Fund, a stipend of up to 95 reais a month that goes to parents who keep their children at school and take them for medical check-ups. The fund now reaches the poorest quarter of Brazil's population. Mrs da Silva notes that the price of rice has “fallen a lot”, another boost to the family budget.

For all this the women credit Luiz Inácio Lula da Silva, the first Brazilian president whose background is as humble as theirs. Accordingly, they will vote for him on October 1st, in the first round of Brazil's general election. And so will many others like them. The man who proclaims the poor to be “every cell” of his body is backed by 57% of the voters who earn up to 700 reais a month, according to Datafolha, a polling firm. Against this bearded Evita, Geraldo Alckmin, a former governor of São Paulo, Brazil's most populous state, has been struggling.

Lula will probably win, in the second round on October 29th if not in the first, because in the eyes of most voters he has kept the promises that matter. While showering money on the poor, he has cut inflation, created jobs and kept the economy growing. Foreign debt no longer hangs over Brazil like the blade of a guillotine. The economy is enjoying “the best fundamental conditions of the past 30 years”, boasts Antonio Palocci, a former finance minister who is now a congressional candidate for Lula's Workers' Party.



And yet Brazil is not as sound as Lula's popularity ratings. Economic growth has been slow by comparison with other countries in Latin America, and with the three “BRIC” countries—Russia, India and China—the less-developed world's leading economies (see charts). A big reason for this is a huge public sector, which keeps interest rates high and has only grown more voracious under Lula.

The list of reforms needed to perk up the economy is not much shorter than it was when Lula took office in 2003, and other issues have grown in urgency. Brazil's dismal standard of public education suddenly seems intolerable, prompting the president to campaign on the clunky slogan “development with income distribution and quality in education”. And crime moved up the agenda when a prison-based gang in São Paulo started attacking police and public transport in May.

Then there is corruption, which does not worry garlic-shellers but enrages the newspaper-reading elite. Although graft carries no party card, much anger is directed at the ruling party and Lula himself, partly because they were once seen as the holders of the Brazilian patent on political purity. A scandal erupted in May 2005 which involved Lula's closest associates bribing congressmen to back the government. Now the final days of the campaign are being muddied by allegations that Lula's advisers tried to buy a dossier supposedly implicating José Serra, the candidate for the governorship of São Paulo from Mr Alckmin's Party of Brazilian Social Democracy (PSDB), in another scandal. The electoral court could cancel Lula's election if it were proved that he had benefited from wrongdoing. More likely, the scandal could undermine Lula's capacity to govern. The political system itself has become a top election issue.

Efficiency must wait

No saviours are on the ballot. Mr Alckmin is “much more prepared [than Lula] to make the state efficient” and therein lies the big difference between them, says Aécio Neves, the PSDB governor of Minas Gerais, whose re-election is even more certain than Lula's. This rings true. The next president's most urgent task seems impossible: to curb the state's appetite for both resources and economic influence while raising investment and improving services like education.

Lula is not the ideal agent to bring about change. He and his party embody an alliance between the dispossessed and those who benefit from an indulgent state, such as union members and public-sector workers. Some of the government's mistakes can be traced to the false notion that what is good for the one is good for the other, not surprisingly perhaps, given that Lula, born poor, became a union leader.

Tax-and-spend habits were already entrenched when Lula took office, but he has not changed them. Instead, he has turned his attention to social policy. While suppressing inflation and containing the deficit, he has transferred more cash to households, partly through the Family Fund, which helps the poor, but also through increases in the minimum wage, which raises publicly financed pensions. The upshot is that the central government's current spending is set to rise from 16.9% of GDP in 2003 to 19% this year, says Raul Velloso, a specialist in public finances.

The mix of subsidy and stability, though, has done wonders for the poor. The poverty rate, as measured by the Getulio Vargas Foundation, a business school, fell from 28% of the population in 2003 to 23% last year, which was comparable to the improvement brought about by the end of hyperinflation in the early 1990s. Lula's critics carp that the Family Fund merely alleviates poverty without providing an exit. That is to underestimate the value of reducing misery. The trouble is that although the total real income of Brazil's poorest households rose 28% between 2004 and 2005, that of the middle class increased just 1.6%.

Well-being in Lula's Brazil is unevenly spread in geographic terms, too. Cash transfers have animated the economy of the poor north-east, where retail and wholesale trade jumped 15.6% in the year to July. But this will tail off when the government ratchets back increases in handouts, as it must. In the southern state of Rio Grande do Sul, the economy shrank 5% last year because of drought, which hurt farming, and the strong real, which damaged industries such as shoe- and furniture-making. The economy of Rio de Janeiro, the second-largest city, has not grown since 1975. Enterprise there is thwarted by bureaucracy and high taxes. A third of the income in the metropolitan area comes from pensions.

As Rio's stagnation suggests, the blame must be shared by earlier administrations and all levels of government. But Lula has done too little to spark higher growth. Investment, the best indicator of the economy's long-term health, has edged up from 18% of GDP in 2003 to 20%, not enough to sustain growth rates of more than 4%. Lula promises that investment will rise to 25% of GDP in his second term, but how?

His government has done several useful things, such as passing a bankruptcy law. A long-delayed measure to encourage the private financing of public works may at last yield results. And, after a shaky

start, a new model for commissioning power generation is starting to show it can attract private capital to the electricity industry.

Ignore or overrule

But this is not enough. The central government is responsible for investment amounting to only 0.8% of GDP. Its attitude towards regulatory agencies, whose independence should encourage investment in infrastructure, has bordered on hostility. The telecoms ministry has more than once sought to overrule Anatel, the industry regulator. And investment in sanitation has been stuck at a derisory 0.2% of GDP for the past seven years, leaving a quarter of Brazil's urban population lacking access to sewerage.

The reforms required to boost Brazil's growth are as familiar as old jokes. They include formal independence for the Central Bank, which would allow it to achieve its inflation target with lower interest rates, lower trade tariffs, a simpler tax system and, above all, a long-term plan to reduce spending and the net public debt, which at present stands at about half of GDP. With taxes close to their limit (tax revenue hit a record 37% of GDP last year) and spending rising inexorably, the government will struggle to deliver the primary budget surplus (ie, before interest payments) of 4¼% of GDP that it has promised.

“It's clear this model is almost exhausted,” says Marcos Mendes, an economist in Brasília, the capital. A better one would, among other things, give the government more discretion over spending, 90% of which is tied to items like pensions and health, and breaking the link between the minimum wage and pensions. All would inflict political pain.

Brazilians wonder whether new models can be built with the same old politics. Mr Alckmin, a tax-cutting technocrat who has run an uninspired campaign short on detail, might just do better. But the inertia built into Brazil's institutions may get the better of any candidate. The 1988 constitution is a busybody document with something to say on everything from the structure of the police to tuition fees at public universities (forbidden). It directs the government to hand about half its tax revenue to the 27 states and 5,500 (often financially incontinent) municipalities. IPEA, a research institute, says they wasted 16 billion reais in 2000, 1.5% of GDP. Many economic reforms require a constitutional amendment that must twice win three-fifths majorities in both houses of Congress. This will hobble any president.

Moreover, many of the issues exercising voters, including crime and education, are the responsibility mainly of the states and municipalities. Much therefore depends on give and take between the president and the other branches and levels of government. The voters this Sunday will elect all state governors and legislatures, the lower house of Congress and a third of the Senate, as well as the president.

Of the 27 states, 19 are expected to re-elect incumbent governors or successors from the same parties. The current Congress is widely seen as the most corrupt in history. The next one may even have a seat for Fernando Collor, a president impeached in 1992, and Mr Palocci, who has been charged with infractions while he was a mayor. Brazil's “presidential coalitionism,” in which a directly elected president must fashion majorities from a fragmented Congress, is never easy to manage. Lula's administration has fared worse than most, only grudgingly giving allies top government jobs, which has left bribery as one of the few ways to recruit support. That so many congressmen are eager to succumb—nearly a fifth of the lower house is implicated in some scandal—has something to do with the way they are elected.

The missing link

With 5,406 candidates competing for 513 seats in the lower house, the congressional vote amounts to a mass beauty contest. Few of the aspirants have more than casual contact with their constituents, partly because they represent whole states rather than districts. The system is proportional: the number of votes won by a party or its candidates determines how many seats it gets in each state. Within that quota, the winners are those with the most individual votes, which may not be many.

Over half the voters generally forget which congressmen they have voted for. Winning candidates can, and often do, switch parties after the election, further straining their link with voters. This “deficit of representation” makes it difficult for voters to scrutinise their representatives and for presidents to build stable coalitions. That encourages corruption.

The answer, many believe, is political reform. One element is already in place. In the next Congress

parties will for the first time have to cross a threshold—5% of the national vote—to secure various privileges, including free television time. The number of parties, 16 at present, may be halved. Other reforms may include penalties for politicians who switch parties, public money for campaigning and voting for party lists instead of single candidates.

That would not be a cure-all. Party voting and penalties for party-switching would strengthen parties and citizens' monitoring of their representatives, which ought to reduce corruption. But much of the representation deficit has to do with wider economic and social conditions. A poor and badly educated electorate is unable to control the behaviour of politicians, says Claudio Weber Abramo of Transparência Brasil, an anti-corruption NGO. Designing a new electoral system might distract from the more urgent task of economic reform.

Some Brazilians are not altogether downhearted, though. Their country may be growing more slowly than the other BRIC countries, but its institutions are sturdier, asserts Antônio Delfim Netto, a congressman from the centrist Party of the Brazil Democratic Movement. In Brazil party politics is virtually the only politics, points out Fátima Anastasia, of the Federal University of Minas Gerais, which makes it more stable than such neighbours as Bolivia and Venezuela, where strikers and strongmen hold sway.

AFP

The Family Fund has worked

Even without reform, the meshing of growth and democracy keeps Brazil moving forward with occasional bursts of speed. That is certainly true in Minas Gerais, where Governor Neves claims to have eliminated the budget deficit and applied a “management shock” to the bureaucracy. “Results agreements” pay bonuses to civil servants in exchange for hitting targets such as cutting the number of prison escapes. “We're gradually changing the mind-set of the civil servant, who used to pass the exam [for his job] and then sit passively in his chair,” claims Antonio Anastasia, Mr Neves's running-mate. Mostly hype, sniff his critics, who claim, among other things, that he balanced the books by cutting health spending and cares more about efficiency than ending poverty.

Yet in Contagem Mr Neves's entrepreneurial approach has made a difference. Unlike the *favelas* of Rio de Janeiro, where gun-toting adolescents rule, the poor parts of Contagem were not abandoned by the state. Minas Gerais created special teams of police to patrol violent areas. The notorious Nelson Hungria prison no longer erupts. The state employs nearly 400 people in “social prevention” projects such as Stay Alive, which lures the young away from crime with computer training, football and other activities. And the local monthly murder rate has dropped from double to single digits.

Lula's party is allergic to the idea of management shocks but their spirit is spreading, for example, to education, where it may be needed most. Lula has been rightly skewered for ignoring basic education

during his first three years in office, but that seems to be changing. Last year, for the first time, the education ministry tested all primary public schools in urban areas. In June it published the results of the national tests, school by school. Now each will be given its own targets to improve its scores.

Shock treatment needed

To help meet those targets the government intends to distribute an extra 5 billion reais to schools in the ten poorest states. A thousand teacher-training centres are to improve teaching quality. A genuine management shock would allow school directors to choose their teachers and would hold them accountable for the results. Fernando Haddad, the education minister, admits that Brazil is still in the “ante-room” of such a discussion but thinks targets and tools will “change the culture” of education. By 2022, he says, Brazil's scores should be as good as the industrial-country average.

It is indeed possible that the national tests could click with Mr Neves's results agreements and the Family Fund's education requirement to lift young Brazilians into useful work. But if that is to happen quickly, Lula will need to act. He has proposed a national pact for reform after the elections. But the attempt to smear Mr Serra threatens to disrupt his second term before it begins. The price could be four more years of underperformance.

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Terrorism and Iraq

Stating the obvious

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From The Economist print edition

AP

A new report makes a plain case that invading Iraq has been counterproductive

THE war in Iraq has “made the overall terrorism problem worse.” Many Islamist extremists consider it to be the first front of a total war against Islam. It has galvanised jihadists, becoming their “cause célèbre”, and it has contributed directly to increasing recruitment of violent Islamist terrorists. The terrorist threat is now more acute than it was before the September 11th attacks on the United States.

These blunt conclusions, leaked last week to the *New York Times* and the *Washington Post*, are part of a classified National Intelligence Estimate (NIE) on global terrorism trends. Such estimates are the consensus opinion of 16 government agencies, including the CIA, FBI, State Department and all four branches of the armed forces. They are hard to dismiss by any but the wilfully dim-sighted. “Stating the obvious”, one leaker said. But it has never been obvious to the Bush administration.

The White House has repeatedly insisted that America is safer now than it was before the World Trade Centre was demolished. It still believes it. Faced with the leaks, spokesmen insisted that nothing in them about Iraq was new, and that the NIE was not much about Iraq anyway. Hopeful things could be found in it: al-Qaeda's operations had been disrupted by American efforts, and its leadership damaged. And the report said that jihadism was fuelled by corruption and injustice in Muslim countries, as well as by the war.

As for the timing of the leaks—the administration's defenders continued—liberal spies were doubtless in cahoots with the press. The NIE came out in April, but no one was jawing about it to reporters back then. “Here we are, coming down the stretch in an election campaign, and it's on the front page of your newspapers,” fumed George Bush at a press conference. “Isn't that interesting?” Sulkily, and only because both Republicans and Democrats were badgering him, he agreed on September 26th that the NIE should be declassified and parts of it made available.

The declassified excerpts corroborate the anonymous sources. The Iraq war is one of several “underlying factors...fuelling the spread of the jihadist movement”. But new cells and new websites are carrying the message that the Iraq war is a Western attempt to conquer Islam. If this movement keeps growing, says

the report, “threats to US interests at home and abroad will become more diverse, leading to increasing attacks worldwide.”

The military top brass have also been joining this chorus. On September 25th three of them, retired but still influential, accused the secretary of defence, Donald Rumsfeld, of mismanaging the war, and said he was “incompetent strategically, operationally and tactically”. They demanded his head and those of his team, though on past form they will not get them. General Peter Schoomaker, the army chief of staff, has refused to submit his budget plan for 2008 to Mr Rumsfeld, arguing that unless he has more money he cannot possibly carry out the army's operations in Iraq or elsewhere. The army's commander in the Middle East has already said there is little chance of drawing down the 140,000 troops already in Iraq before next spring.

The Republicans have long held the advantage on issues of terrorism. They used this advantage to win the mid-term elections in 2002 and the presidential election in 2004. Karl Rove plans to go to the well yet again this November. But the strategy gets a bit harder each time, as the administration shifts its justification for war and as the insurgency becomes more toxic. And the leaks strike at the heart of the Republican strategy, which is to roll the Iraq war into the general war on terror and claim that “fighting them over there means we do not have to fight them over here.” The polls show a relentless downward trend in the number of people who believe America did the right thing by going into Iraq.

America is now so partisan that some people will stick with the president come what may. Moreover, both George Bush and the Republicans have recently seen their fortunes rise: Mr Bush's popularity rating has been creeping up and the Democrats' lead in generic congressional polls has been shrinking slightly. But this carefully timed leak is a double blow to the president. It shifts attention away from the general war on terrorism to the Iraq war; and it puts a question-mark against the last remaining justification for that war of choice, that it is making America safer. No wonder the Republicans are fighting back with everything they have.

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The mid-term elections

In hostile territory

Sep 28th 2006 | MARYVILLE, TENNESSEE AND TYSONS CORNER, VIRGINIA
From The Economist print edition

Can the Democrats make gains in the heavily Republican South? A look at two Senate races, in Tennessee and Virginia

SOME audiences are easier than others. The students at Maryville College are as liberal as you will find in eastern Tennessee, so Harold Ford, a Democrat running for the Senate, has no trouble wowing them. He's young, clever and says the government should pay for college tuition. After a sunny speech, the audience's questions are mostly either friendly or lovestruck. “Mr Ford, will you marry me?” asks one girl, just out of the candidate's earshot.

The rest of Tennessee is a bit more conservative than Maryville College. As Mr Ford once said, “The national image of the Democratic Party does not sell well in the South.” So he is running as far from his party as he credibly can. At the Kiwanis Club nearby, where several members are boycotting his speech simply because he is a Democrat, Mr Ford boasts that he has never voted for an unbalanced budget, that he would never hire an illegal immigrant and that he gets “jumped on” a little by his own party because he goes to church a lot and loves Jesus.

This audience is not predisposed to like him, but they do. He says George Bush should have greater powers to thwart terrorists. He proposes to shut the borders to new immigrants for 45 days, to find out who's here and what they're up to. He wants to eliminate the tax code's bias against marriage—between a man and a woman, that is. The only strike against him, with this audience, is that he would not criminalise abortion.

To win the Senate in November, the Democrats need to gain six seats. Tennessee is, by some measures, the sixth-most-vulnerable Republican-held one. It is open because Bill Frist, the Senate majority leader, is retiring. If anyone can turn the Volunteer State blue, it is Mr Ford. His Republican foe, Bob Corker, is rich but unexciting. The national trend is towards the Democrats. But still the race is a toss-up.

Mr Ford has both youth and experience on his side. Though only 36, he has been in politics for 32 years, since he first starred in a campaign commercial for his father, Harold Ford senior, calling for “lower cookie prices”. He inherited his father's seat in the House of Representatives as soon as he was old enough to stand for election, and has been tipped as a future star ever since. In 2000, he was a keynote speaker at the Democratic National Convention. The next year, *People* magazine named him one of the 50 most beautiful people in the world. But to win in Tennessee, he will have to convince a lot of voters he is not a liberal.

Despite his Republican-lite bonhomie, this is hard. A liberal pressure group has rated him the most liberal Tennessee congressman. That is a label akin to “wussiest linebacker for the Tennessee Titans”, but Republicans are making sure everyone hears about it. One ad, after accusing him of being soft on terrorists and illegal immigrants, flashes the word “liberal” on the screen like a neon warning sign.

Mr Ford has other handicaps, too. He is black, and he comes from a family of machine politicians with ethical hiccups. His uncle, a state senator, was indicted on corruption charges the day after his nephew announced his candidacy. Mr Ford deals smoothly with both issues. To those who will not vote for him because he is black, he says “God bless your heart.” To pre-empt questions about dodgy relatives, he says: “My dad's family gets all the attention...but my mother's got a family too.” He then recounts how his maternal grandmother taught him right from wrong with a wooden switch.

The Democrats will forgive Mr Ford any amount of pious pandering if he wins. And, despite the populist excesses of his campaign, he would be a thoughtful addition to the Senate. But however charming Tennesseans may find Mr Ford, they know that voting for him could flip control of the Senate and hand

power to people such as Ted Kennedy and Hillary Clinton. And that, most feel, would not be good.

A non-southern strategy

Democrats do badly now in the South. The conventional wisdom is that the party should redouble its efforts to appeal to “Bubba”, the white working-class southerner who loves God and guns and bristles at the condescension of effete north-eastern liberals. For Mr Ford, this is obviously a sensible strategy. But for the party as a whole, Thomas Schaller, author of “Whistling Past Dixie: How Democrats can win without the South”, thinks it is bunk.

Why, Mr Schaller asks, do Democrats want to spend so much time and money courting a group that is reflexively hostile to them? Rather than chasing southern whites, Democrats should be pursuing swing voters in Ohio or Pennsylvania, who might actually listen to them. And in the long term they should exploit friendly demographic trends, such as the migration of liberal Californians into sparsely populated neighbouring states.

Americans' mobility makes politics unpredictable. Virginia, for example, is always assumed to be solidly conservative, but an influx of liberal high-tech and government workers is making it less so. Throw in a series of gaffes by the incumbent Republican senator, George Allen, and the race suddenly looks competitive.

Mr Allen is an affable, tobacco-chewing ex-governor. Virginia has a one-term limit for governors, so for six years he has been biding his time in the Senate, plotting a presidential bid. Re-election this year was supposed to be a formality. But suddenly Mr Allen has found himself fending off charges of racism. First, he referred to a young Indian-American as *macaca*. He says he made the word up, but it turns out to be a racial slur in North Africa.

Mr Allen's mother is from Tunisia. There was also a rumour that she was Jewish. At a debate with his Democratic opponent, Jim Webb, a tone-deaf TV reporter asked Mr Allen: “Could you please tell us whether your forbears include Jews?” The audience booed. Mr Allen said his mother was raised as a Christian. But it turns out that she wasn't, and Mr Allen lied about it. His mother says she hid her Jewishness when she emigrated to America after the Holocaust, and never told her son until last month. Even then, she says she asked him to keep quiet about it. So maybe he lied to protect his mother, but voters would doubtless prefer him not to lie at all.

Finally, two college mates claim that, when young, Mr Allen used racial epithets so offensive that prissy American newspapers cannot print them. The *Washington Post* quoted one of them alleging that Mr Allen once pointed to turtles in a pond and said only “the [epithets] eat them”. Mr Allen denies calling anyone an epithet.

Mr Allen will probably win anyway, though his presidential hopes are in ruins. Mr Webb, his opponent, is impressive, a decorated Vietnam veteran who served as navy secretary under Ronald Reagan. But he is a stiff, unsmiling campaigner, whom Mr Allen will massively outspend.

For the Democrats to capture the Senate, they will almost certainly have to win either or both of Tennessee and Virginia. Whether they do will have global consequences. But whether they can depends largely on local issues such as traffic congestion, and whether voters think Mr Allen is a bigot.

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The economy

Going down?

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Why the housing slump may spell recession

THREE years ago Rose Hill estates was a dairy farm in Loudoun County. Now it is in the front line of America's housing slump. The rolling fields are dotted with cut-price McMansions. The asking price for new houses, complete with gourmet kitchens and “extended libraries”, has been slashed by 20%. But business is slow. The pace of home sales in the county has halved since last year while the stock of unsold homes has doubled. “The region is glutted with new houses,” says Lenn Harley, an estate agent. “The market is dead.”

Loudoun County, an exurb of Washington, DC, is an extreme example. But there is no longer any doubt that America's housing bust is both bigger and more abrupt than many expected. Nationally, new home sales are down 17% from a year ago, and sales of existing homes have slumped 12%. By some measures, prices are now officially falling. New numbers released this week by the National Association of Realtors (NAR) suggest that the median price for existing homes fell by 1.7% in the year to August, the first such national drop since 1993. The median price of new houses fell by 1.3%.

And although August's figures were less grim than expected, there is clearly more to come. The supply of existing homes for sale is up 60% from a year ago, is at a 13-year high and is still rising. Builders are at their glummest in 15 years. Even the NAR, long the chief cheerleader of the housing boom, now admits that prices will drop further.

Today's debate is less about the scale of the housing slump than its consequences. Will America be dragged into recession or will lower oil prices help the economy shake off the property bust? Most Wall Street economists put the odds against a recession, but a noisy minority claim it is virtually inevitable.

Who is right? The economy is slowing sharply—economists now expect annualised GDP growth of around 2%, or well below trend, in the third quarter—and much of the macroeconomic impact of the housing bust is still to come. The most direct and least debated effect is the drag on overall output as builders cut back. Given the plunge in new home starts and the builders' gloom, residential investment is probably falling by around 15%-20% at an annual rate and is likely to do so for at least the next few quarters. That alone will shave a percentage point off overall economic growth.

Add in the effects on employment, and the impact will be bigger. Early in this expansion, a large chunk of job growth came from housing. During 2004 and 2005 it was around 15%, or about 20,000 jobs per month. As housing stumbles, economists at Goldman Sachs reckon the industry will shed jobs at a similar pace, pulling overall job growth below 100,000 a month and pushing up the unemployment rate. Again, much of the effect lies ahead: builders were still adding workers in August.

These direct consequences of the housing bust will slow the economy. Whether it is dragged into recession depends on the indirect effects, particularly how consumers react. And that is where the real controversy lies. Pessimists argue that a housing bust will sharply crimp consumer spending. More important, Americans will feel less wealthy if their house prices tumble. Nor will they be able to use their houses as giant cash-machines, financing their spending by withdrawing the equity. By some estimates, half the equity money cashed out of homes is spent.

Optimists make several counter-arguments. First, they play down the link between mortgage-equity withdrawal and consumption, pointing out that the pace of equity withdrawal has already slowed without dire consequences. Robert Mellman of JPMorgan reckons that the pace at which Americans withdrew cash from their homes fell from a high of 7.9% of disposable personal income in the third quarter of 2005 to 3.3% in the second quarter of 2006. Although consumer spending slowed over that period, it did not

collapse. If the mortgage-equity link is weaker than expected, then falling house prices may have a milder effect on consumer spending. Possibly so; though the figures so far do not prove it, not least because a drop in equity withdrawal may take time to show up in lower spending.

Second, optimists argue that the chilling effects of weak house prices will be countered by other boosts to the consumer, particularly from lower fuel prices and strong income growth. Richard Berner of Morgan Stanley points out that wages and salaries have grown by 8% in the past year, and that petrol prices have fallen by 60 cents a gallon in the past month.

No one doubts that lower fuel prices are fattening consumers' wallets and boosting their spirits. Consumer confidence is rising, after tumbling in August. Nonetheless, these spending supports are less sturdy than they seem. Much of the increase in worker compensation was in stock options for the highest-paid rather than broad-based wage rises; if unemployment rises thanks to the housing shake-out, overall income will suffer. As for oil, it is hardly cheap. In the short term, lower-cost fuel helps the over-stretched consumer. But it will not remove the pain of a housing bust that is far from played out.

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Drugs in the Midwest

The other Mexican wave

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Local drug labs may be closing, but methamphetamines still pour in

STUNNED by the spread of methamphetamine use in rural and small-town America, lawmakers and the police have been cracking down on local production for the past couple of years, apparently with success. But the huge leap in meth use since the mid-1990s has left plenty of addicts across America's heartland craving for the stuff—and organised drug pushers from Mexico and the south-west have been happy to rush in and supply it.

Although meth use is widespread, it has hit some rural areas hardest. This is because it is synthetic, and—unlike other imported drugs, such as heroin and cocaine—it can be made by people at home or in the woods in small makeshift laboratories, often with recipes that are easy to find on the internet. Meth laboratories have tended to sprout in sparsely populated regions, for two reasons. One is that the labs emit noxious fumes that bring unwelcome attention in places where neighbours live close by. The other is that anhydrous ammonia, an important ingredient in making meth, is a common chemical in fertilisers, and is therefore easy to buy or steal in farm country.

Michael Behm, the executive director of Nebraska's crime commission, remembers being warned about meth production in the mid-1990s, when he was a state trooper. His counterparts in neighbouring Missouri told him that it was spreading rapidly through rural bits of their state. Before long, he says, he noticed that labs were appearing in south-eastern Nebraska as well, and he started finding the stuff at truck stops and in people's homes. The same pattern was repeated in other states. (The map below, which charts meth use by the numbers of people in rehabilitation facilities, is evidence not of the availability of rehab but of the popularity of the drug). Between 1997 and 2003, 75% of the meth labs found in Illinois were in rural areas, mostly in the south and south-east.

As production began rising, local users began confronting police, teachers and neighbours with a slew of problems, including a predictable rise in violent-crime rates. Many of the short-term effects of meth use, such as a sharp increase in dopamine levels, are far more powerful than those of other drugs. According to America's National Institutes of Health, smoking meth produces a high that lasts 8-24 hours, compared with only 20-30 minutes for cocaine, and the drug takes 12 times longer than cocaine to work

its way out of the body. The crash that follows meth use is also more pronounced than with other drugs, leading users to neglect both themselves and their children.

Over the past couple of years state governments, with federal help, have tried vigorously to crack down on small local labs. One crucial step has been to make some of the ingredients harder to get: especially pseudoephedrine, a common decongestant that could be found on any pharmacy shelf until recently. Oklahoma was the first state to act. It passed a law in 2004 that made it harder to buy more than small quantities of medicine containing pseudoephedrine—or to steal it from off the shelf. Other states followed suit last year.

Those restrictions on raw materials, combined with the police drive, appear to be putting a huge dent in domestic production of methamphetamines. The number of meth labs in Oklahoma fell by 63% in the year after the state passed its law, and by more than half in other heartland states such as Iowa, Kansas, Minnesota and Montana.

But with so many users already hooked on the drug, there is plenty of money to be made by foreign, especially Mexican, outfits that can smuggle it to them. One tell-tale sign, says Mr Behm, is the growing number of lorries stopped by police on Interstate 80—cutting through Nebraska from west to east—which turn out to be carrying meth from the south-west. Since the police can stop drivers only when they violate the rules of the road, Mr Behm reckons that many more lorryloads of the stuff are reaching users in Nebraska, as well as heading north into South Dakota and east into Iowa and the upper Midwest.

The Mexican government has taken a few steps to stop the trade, but smuggling drugs into the United States is even easier than getting illegally across the border. Indeed, the growing proportion of Mexican-supplied drugs in the overall methamphetamine scene has added another visceral symbol to the election-year debate over illegal immigration.

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AIDS in America

Ignorance is not bliss

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From The Economist print edition

America's AIDS epidemic is still not under control. Testing should help

OF THE 1m Americans with HIV, the virus that causes AIDS, some 250,000 do not know they are infected. If they don't know, they will not seek treatment. And they are more likely to infect others. So last week the Centres for Disease Control (CDC) recommended that all Americans between the ages of 13 and 64 should be routinely tested for HIV.

The tests would not be compulsory, of course. But rather than testing only those who ask to be tested, the CDC wants clinics to test everyone who does not refuse to be. The idea is to extend it to more or less everyone who sets foot in a clinic.

Universal screening would be costly, but yield hefty benefits. HIV is easier to treat if detected early. Yet some 40% of Americans diagnosed with HIV progress to full-blown AIDS within a year of that diagnosis, which suggests that they were infected without knowing it for as much as a decade. One recent study found that 76% of staff in emergency rooms rarely or never encouraged HIV testing even for patients who had other sexually-transmitted diseases. They said that the process took too much time, and that they were not qualified to give the required counselling.

The CDC wants to make the process quicker and simpler. It suggests that states do away with laws mandating separate written consent forms for HIV testing, and that they no longer require lectures about safe sex before a test.

Doctors also hope that by making HIV tests routine, they will reduce the stigma attached to them. This is important. The number of Americans with HIV increases each year. This is partly because drugs are keeping people alive longer. What is worrying, though, is that the number of new infections each year has remained stable since the late 1990s. Why does it not fall? The answer lies largely with people who are HIV positive but don't know it. Such people account for 50-70% of new sexually-transmitted infections, says Julie Gerberding, the director of the CDC.

The epidemic hits blacks hardest. They account for nearly half of new infections, despite being only an eighth of the population. Some studies have found that young gay black men are four times more likely to be HIV-positive than young gay white men, and twice as likely as Latinos. No one knows exactly why, but a study the CDC did last year in gay bars and gyms in five cities offers clues. Nearly 1,800 actively gay men were asked about their HIV status and given an HIV test. Only 18% of the whites who tested positive were not already aware they were infected. But two-thirds of the blacks who were infected did not know it.

The most-cited reason for not getting tested was being “afraid to find out”. Some men were worried they would lose their job or family, or that their name would be reported to the government. “There remains a suspicion of the health-care system in the United States among African-Americans,” says Timothy Mastro, an HIV specialist at the CDC.

There is a widespread antipathy to homosexuality, too. “In traditional black male culture, we're taught from a young age to fear the sissy,” writes J.L. King, a bisexual black author. Many black men who have sex with other men do not consider themselves gay. That could affect their willingness to get tested for HIV. Some think public-health messages aimed at gay men do not apply to them. Others, fearing ostracism if their neighbours know they are gay and HIV-positive, shun testing because “if they don't know, they don't have to lie about it,” says Luke Johnsen, medical director of an AIDS clinic in Washington, DC, one of the worst-hit cities.

Whether routine testing can side-step the stigma remains to be seen. No other rich country does it, but then few rich countries have such a severe HIV/AIDS epidemic. American lawmakers, hospitals and insurers do not have to implement the CDC's recommendations, but they will take them seriously. “It's a big step towards normalising HIV,” says Kevin de Cock, the top AIDS man at the World Health Organisation. “That's extremely important.”

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Moose-hunting

Maine's mania

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The quest for trophies in the frozen north

“MOOSE!” The magic word came about nine hours after the day's 4am start, and the hunter hopped out of the pick-up and loaded his .300 Magnum rifle. The target, a young bull, was grazing on brush in a field nearly a quarter of a mile away, against the spectacular red-gold backdrop of the autumn Maine hills. This moose was in luck: its life was spared. “Let's go find one with a bigger rack,” said the trip's leader, Sean Lizotte of Allagash Guide Service, after peering through his binoculars.

This week has not been pleasant for Maine's 29,000 moose, revered as a symbol of the state. More than 1,000 hunters are roaming the northern woods, eager to bring home trophy antlers and freezers full of meat. The shooters had until September 30th to get their beast. This particular time is ideal because the moose are in rut, but a second week of hunting takes place in mid-October. About three-quarters of hunters succeed in bagging a moose, and roadside weigh-stations in northern Maine are festooned with their dangling carcasses.

Killing a moose is far easier than getting permission to do so. Many people wait a lifetime to take a crack. This year there were more than 65,000 applications for permits—more than twice the number of moose in the state. Only 2,825 won the “lottery”, which is such a big deal that names of the winners are read on the radio and printed in the local newspaper. Even children aged ten, who can legally hunt in Maine, enter their names. Pursuing a moose is a family affair in any case, with sometimes half a dozen people, including children, driving round with the hunter.

The sport has changed in recent years. From 1945 to 1980 moose-hunting was banned because the animals were scarce. Years of careful regulation have paid off—and in 1999, in an effort to manage its moose population better, Maine increased the number of permits by a third. Moose-hunting also got easier last year, when electronic calls—which simulate the moose's grating bellow—were allowed for the first time.

Curiously, the sport flourishes on the back of Maine's biggest industry, timber. Moose prefer to dine on young hardwoods, such as poplar or maple, which grow in areas that have recently been clear-cut (they also like to munch broccoli in central Maine's farm areas). So the top hunting grounds lie on private land, along a mesh of logging roads. Landowners charge a nominal access fee, and allowing hunting is good public relations for the timber companies.

The sport does not end with the death of the moose. Maine is full of horror stories of people unable to lug out the animals after the kill. Moose can weigh 1,000lb, or 455 kilos, even after being gutted (it is best to leave the entrails in the woods). The timber industry helps out by lending skidders, which are normally used to haul logs. Meat-cutters spring into action too. Mr Lizotte shot a moose last year and sliced it up himself. A year later his family is dining on moose at least twice a week—and still has quite a bit left.

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Lexington

Mitt Romney's problem

Sep 28th 2006
From The Economist print edition

Religious prejudice may yet undo the Republicans' latest favourite

YOU can say what you want against American politics. You can call it corrupt, vulgar, interminable, and boringly limited to two behemoth parties. But you cannot accuse it of lacking in drama. The mid-term elections are still a month away, but some of the most intriguing action is taking place in the race for the presidency. Mitt Romney, the governor of Massachusetts, is making a concerted bid to seize the mantle as the leader of "the Republican wing of the Republican Party".

Mr Romney is a scarily perfect presidential candidate. He has handsome looks—a mixture of Ronald Reagan and JFK, according to fans—and fearsome intelligence. He graduated from both Harvard Law School, cum laude, and Harvard Business School in the top 5% of his class. He is a Republican governor of liberal Taxachusetts, a sprig of a powerful mid-western political dynasty, and is much admired as a businessman. But Mitt has one big problem: Mormonism. Hence one of the liveliest debates on the right: can a Mormon win the presidency?

Two years before a presidential election might seem a bit soon for such questions. But this is the age of the "permanent campaign". And the Republicans have a habit of anointing their champion as early as possible: George Bush had the nomination locked up by the late 1990s. John McCain has made a good job of turning himself into the party's heir presumptive. But now Mr Romney is mounting a powerful assault from the right.

On September 22nd he delighted 1,800 "values voters" gathered in Washington, DC, with a barn-storming defence of traditional marriage and patriotism. He has vocally defended Mr Bush's policies on the interrogation of suspected terrorists, and suggested that the authorities should spend more time monitoring mosques. For a growing number of conservatives he is the answer to their prayers: a man who can not only derail the McCain Express but also hold the White House in 2008.

Mr Romney's emergence as a conservative champion owes something to luck. His two biggest rivals on the right have imploded: Bill Frist because of his lacklustre performance as Senate majority leader, George Allen because of his gaffe-ridden Senate campaign. But it owes more to years of investment. Mr Romney has not only fought harder than any other governor on "social issues", particularly gay marriage.

He has done so in the heart of enemy territory.

Mr Romney won the governorship of a state where only 13% of the voters are registered Republicans, and where the congressional delegation is 100% Democratic. And he succeeded in working with a legislature where 87% of the members represent the other party. When he was elected governor of Massachusetts in 2002, he found a $3 billion budget deficit; two years later he was running a surplus of more than $700m.

His hallmark before his recent fire-breathing reincarnation was pragmatism and competence. He founded Bain Capital, one of the country's most successful venture-capital companies. He was at the heart of two dramatic turnarounds, first of Bain & Co (which was on the verge of going under when he was brought in as CEO) and then of the 2002 Winter Olympics in Salt Lake City (which threatened to collapse under the weight of bribery scandals and $400m-worth of debt). As governor of Massachusetts, he produced an eye-catching health-care reform that tries to use market mechanisms to solve the most pressing problem, lack of coverage for the uninsured.

Yet Mr Romney is a devoted Mormon—a former bishop, no less—at a time when religion is playing a growing role in American politics. Opinion polls suggest that anti-Mormon feeling is one of the most enduring religious prejudices in America. An *LATimes*/Bloomberg poll in June found that 37% of Americans would not vote for a Mormon presidential candidate; other polls put the figure at 17%.

Anti-Mormon feeling is particularly strong among Bible-believing Christians, a vital part of the Republican base. Many evangelicals regard Mormonism as nothing more than a cult: and a cult, moreover, that is based not only on a false theology but also on a willingness to tamper with the inerrant word of God that is the Bible.

Looking past Mormonism

So will the whiz-kid governor be doomed by the Book of Mormon? Not necessarily. That 37% is certainly not an encouraging figure. But back in 1960 35% of people told pollsters that they would have qualms about voting for a Catholic, and in that year a Catholic reached the White House. Today, 21% of people say they would have qualms about voting for an evangelical; time may tell differently. For most voters, religion is just one factor among many that they consider: there is a difference between rejecting a generic Mormon and rejecting a smooth operator with a plan for universal health insurance.

As for evangelical Christians, they can be a remarkably pragmatic bunch. They have spent the past few decades building alliances with “people of faith” whom they once regarded as spawn of the devil. And they know a winner when they see one: they happily forgave Reagan his divorce and eccentric theological views. In an ideal world they might prefer a more orthodox man of faith. But if it comes to a choice between Mr Romney and a maverick like Mr McCain or an avowed social liberal like Rudy Giuliani, they may be willing to swallow the Book of Mormon.

Mr Romney's opponents may well find other weaknesses to exploit. He is a somewhat bloodless candidate, a conservative of the head rather than the heart, and approaches presidential politics rather like a Harvard Business School case study. First, prove that he can run a state; then lock up the conservative base; then pivot back to the centre . But for the moment at least it seems that conservative Republicans have found their man for 2008.

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Venezuela and the United States

The world according to Chávez

Sep 28th 2006 | CARACAS AND WASHINGTON, DC
From The Economist print edition

Reuters

Venezuela's bid for a UN Security Council seat has divided Latin America

Get article background

HE MAY give the impression of being the clown prince of world politics, but there is often calculation behind Hugo Chávez's verbal fireworks. So it was with his speech to the United Nations General Assembly earlier this month, in which he denounced George Bush as “the devil” and the “tyrannical president of the world”, and plugged an anti-imperialist tract by Noam Chomsky, a far-left American academic. The speech brought criticism of Mr Chávez from former friends in the Democratic Party in the United States, but it was not aimed at them. Mr Chávez is a man with two elections to win.

In December, he will seek another six-year term as Venezuela's president by claiming that his “revolution” is under threat from the United States. But the vote uppermost in his mind comes in mid-October, when Venezuela hopes to win a rotating seat on the UN Security Council assigned to Latin America. Rather than representing the region's interests, as is customary, Mr Chávez wants to use the seat to “radically oppose the violent pressure that the empire [ie, the United States] exercises in the world”.

According to its ambassador to the UN, Venezuela wishes to speak “for those peoples who have no voice”. This seems to mean opposition groups in countries whose governments Mr Chávez dislikes. Once inside, he wants the “refounding” of the UN, rather than its reform.

In pursuit of the seat, Mr Chávez has cast his net far wider than Latin America, visiting more than two dozen countries on five continents this year, many of them more than once. Flush with an oil windfall, he has lavished his hosts with donations, and trade and investment concessions. He denies that this amounts to lobbying for votes. But most visits have been accompanied by statements (often by Mr Chávez rather than his hosts) of support for Venezuela's UN candidacy.

His diplomacy has split Latin America. Mexico, Central America (except Belize) and Colombia are supporting the rival candidacy of Guatemala, announced before Venezuela's and backed by the United States. Venezuela claims the support of the Mercosur countries (Argentina, Brazil, Paraguay and

Uruguay), Bolivia and much of the Caribbean. Peru and Ecuador will probably support Guatemala. Chile has been wavering: Michelle Bachelet, the president, leans towards Venezuela, but much of her centre-left coalition does not. Recent criticism of its stance by Venezuela's ambassador will probably force Ms Bachelet to abstain.

Farther afield, Guatemala has the support of most of Europe's democracies. Mr Chávez claims the backing of the Arab league, much of the African Union, and China and Russia. Some of this support is based on shared anti-Americanism—thus the UN speech. But some of it appears to be the fruit of petro-diplomacy.

The cost of this to Venezuela is impossible to calculate. Much of the government's spending is off-budget and at Mr Chávez's discretion (which violates the constitution he himself introduced). A recent study by CIECA, an opposition-leaning research centre, puts at $50 billion the total foreign spending announced by the government in the past 18 months (though this seems to involve some double counting). It includes a $10 billion anti-poverty fund, which officials say has already financed an electrification plan for Havana, a hospital in Uruguay, and subsidised heating oil for poor districts in the United States.

Argentina has benefited from Venezuela's purchase of $3.1 billion of its bonds. Other outlays come more clearly under the heading of outright aid. Jamaica was offered a $300m motorway. Bolivia has been showered with gifts, including asphalt for its highways, student grants and the indefinite loan of two large helicopters. Over 300,000 barrels a day of Venezuelan oil products is sold at a discount under a variety of concessionary deals.

Many of the headline sums lack a timetable. If true, they are out of all proportion to the financial capacity of a country where at least 35% of the population still lives in poverty, despite the government's oil windfall. Many of the promises look wildly unrealistic. Mr Chávez has talked of building or upgrading oil refineries in Brazil, Cuba, Ecuador, Jamaica, Syria, Uruguay and Vietnam, not to mention Venezuela itself. But PDVSA, the state oil company, suffers from a shortage of both skilled staff and cash.

Despite the outlay, Mr Chávez may still not achieve his goal. To be elected, a country requires 128 votes—two-thirds of the General Assembly. Neither Venezuela nor Guatemala is likely to achieve that. Whichever comes second would normally face pressure to step aside. But this time, neither is likely to do so. The onus will then be on the bigger countries in Latin America to come up with a compromise candidate—diplomats mention Uruguay, the Dominican Republic and Costa Rica.

Condoleezza Rice, the American Secretary of State, said this week that Venezuela's election would mean “the end of consensus on the Security Council.” But while it lobbies for Guatemala, the Bush administration has tried to avoid being drawn into a soundbite war with Venezuela.

There is a “surreal” quality to Mr Chávez's rhetorical aggression against the United States, says Thomas Shannon, the State Department's top official for Latin America. Venezuela still exports most of its oil to the United States, and the two countries long had close ties. Though Mr Chávez blames the United States for a failed coup against him in 2002, the evidence suggests that the administration merely failed to condemn it. “This is a fight that Chávez has decided to bring to us, we didn't bring it to him,” says Mr Shannon. It is one that Mr Chávez hopes will win him votes, both at the UN and at home.

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Mexico

Under the volcano

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The governor v most of the people

Notimex

They want to send Ulises and his plain-clothes police on their travels

NORMALLY the streets of Oaxaca, a city of some 250,000 people in southern Mexico, are full of tourists. They come to enjoy the nearby Zapotec ruins of Monte Albán and the city's colonial churches, Indian markets and art galleries. But Oaxaca, designated a world heritage site by the United Nations, is today a much sorrier sight.

For the past four months, it has been in the grip of a bitter political conflict that one local politician calls “a low-intensity urban war.” The Zócalo, the main square, is permanently occupied by several thousand protesters; more are camped out around the city. They have seized several radio stations and public offices. Many streets are blocked by barricades of parked buses or corrugated iron. Angry graffiti, in red and black spray-paint, disfigure many historic buildings.

Not only has this conflict driven off the tourists; it also threatens to complicate the handover of national power on December 1st from Vicente Fox, the current president, to Felipe Calderón, the narrow victor of Mexico's hotly disputed July election.

The conflict, in which five people have been killed so far, began with a strike over salaries by the state's militant teachers, an annual ritual. Matters escalated in June when Ulises Ruiz, the state governor, sent his police force to evict the strikers from the Zócalo. The police, who are accused of handing out beatings, on this occasion received one. The teachers were promptly reinforced by a newly-created Popular Assembly of the Peoples of Oaxaca (APPO), a motley collection of more than 100 community and political groups, ranging from moderate to far-left. Their demand now is the ousting of Mr Ruiz.

While Mexico has become a democracy over the past decade, Oaxaca, one of its poorest and most Indian states, has failed to follow suit. Mr Ruiz belongs to the most authoritarian wing of the Institutional Revolutionary Party (PRI), which governed Mexico for seven decades until Mr Fox won the presidency in 2000. The PRI continues to govern Oaxaca as if in perpetuity, despite well-founded claims by a united opposition coalition that Mr Ruiz's election by a margin of 2% in 2004 was fraudulent.

Mr Ruiz has ruled in a high-handed manner. One of his first acts was to vacate the government palace in the Zócalo and “remodel” the square, ripping up ancient trees. He has united much of the state against him: in the federal election, the PRI lost a Senate seat and nine seats in the lower house to the left-wing Party of the Democratic Revolution (PRD). “Oaxaca is the Mexico of the 1970s, in which there is no allowance for citizen demands or political rights,” says Marcos Leyva of APPO.

The protesters want the federal Senate to exercise its power to oust the governor. But many in the PRI and the ruling conservative National Action Party (PAN) are loth to do so. The PRI, upon which Mr Calderón will depend for a congressional majority, appears to see Mr Ruiz's fate as a bargaining chip. The PAN fears the precedent of yielding to protests that have gone a long way beyond the law. “We respect the sovereignty of the states,” says Mr Fox.

This week protesters armed with clubs and pistols staged a room-by-room search of a city-centre hotel after rumours that Mr Ruiz was inside. The governor claims, without proof, that a shadowy guerrilla group lurks behind the protests; his opponents counter that the state government has organised paramilitary bands.

According to the Chamber of Commerce, the conflict has caused losses of some $300m; in the formal economy alone, 162 businesses have closed with the loss of 350 jobs. The governor wants federal police or troops to restore order. The government has readied plans to that effect. Mr Fox is resisting, doubtless fearing a bloodbath. “We must explore every possibility of dialogue before taking any other action,” the president insists.

But understandably, Mr Calderón wants Mr Fox to settle the matter before December 1st. In Oaxaca, illegitimate authority and the absence of political channels for dealing with grievance are radicalising protest. Tackling the latter but not the former will not bring peace.

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China

Shanghaied

Sep 28th 2006 | BEIJING
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Reuters

Hu Jintao sticks out his elbows and fires Shanghai's party chief

Get article background

POWER struggles in China these days tend not to be as vicious as they were under the rule of Mao Zedong, but the dismissal on September 24th of Shanghai's Communist Party chief, Chen Liangyu, was still redolent of that former time. Photographs of Mr Chen were removed from official websites. So too were his speeches and interviews. Mr Chen's musings on building Shanghai into a “socialist modern international economic centre” mercifully disappeared with them.

Rumours had long been swirling that Mr Chen was in trouble. The arrest in August of Qin Yu, a district chief in Shanghai and a former senior aide to Mr Chen, suggested that the noose was tightening. Mr Qin (who is also a translator of Jean-Paul Sartre) was accused of involvement in the misappropriation of $400m of the city's social-security funds. Now investigators say Mr Chen himself played an unspecified part in the scandal. He is also accused of “seeking benefits for a number of unlawful enterprise owners”, protecting lawbreaking aides and seeking illegitimate gains for his relatives. The government's news agency, Xinhua, said this had created a “vicious political impact”. Several Shanghai officials as well as business leaders are being investigated.

Mr Chen is the most senior party leader to be accused formally of wrongdoing since Beijing's party chief, Chen Xitong (no relation), was forced from office in 1995 and later jailed on corruption charges. In both cases, struggles among top leaders appear to have played an important role. Shanghai's Mr Chen, who studied at Birmingham University in England for a few months in 1992, was appointed as party leader and a member of the Politburo ten years later, at the same time as Hu Jintao became the party's general secretary. Mr Chen clearly owed his rise to the patronage of Mr Hu's predecessor, Jiang Zemin. This made him vulnerable.

But whereas Chen Xitong was a political giant who was seen at the time by Mr Jiang as a direct challenge to his power, there is little sign that Mr Hu's leadership has been seriously threatened by Chen Liangyu. It appears more likely that Mr Hu has moved against Mr Chen in order to demonstrate his resolve in the

face of a more general threat: that of provincial and lower level leaders blithely ignoring the central government's efforts to tame the economy. With the help of compliant local banks, many are investing in lavish new projects and encouraging speculation in real estate. The central government fears this is creating bubbles in the property market that could threaten social and financial stability.

The timing of Mr Chen's fall is important too. The party has just announced that its Central Committee will hold its annual session from October 8th to 11th. A key theme will be how to establish a “harmonious society”. This principally means how to curb an upsurge of protests around the country, fuelled by corruption. During the meeting, Mr Chen is likely to be expelled from the Politburo (his duties have already been “suspended”). By targeting Mr Chen, Mr Hu is, as the Chinese put it, “killing the chicken to scare the monkeys”. In the buildup to a five-yearly party congress due to take place in late 2007, many local officials will end their terms. Mr Hu wants them replaced with loyalists. In Shanghai, the city's mayor, Han Zheng, has taken over as acting party chief, but it is likely that Mr Hu will send one of his protégés to fill the post.

At the central level, there is little sign of any concerted challenge to Mr Hu. Observers of Chinese politics often refer to a “Shanghai gang” of politicians who came to power thanks to their association with Mr Jiang when he was the city's party chief in the 1980s. But Mr Jiang's influence has ebbed considerably since he gave up his last position, as military chief, in 2004. He has kept quiet on state affairs. China's vice-president, Zeng Qinghong, at one time considered a Jiang loyalist, has shown no obvious sign of resistance to Mr Hu. Another Jiang ally in the Politburo's nine-member standing committee, Huang Ju (a former Shanghai party chief), has been ill with cancer for the past several months.

Mr Hu's problem with local governments is largely one of the party's own making. The party decrees that maintaining social stability is of paramount importance. To local officials this means keeping growth rates high, regardless of any damage to the environment or buildup of bad loans in the banking system. When they hear the central leadership call for more rational growth, they reckon that ignoring the centre is less politically risky than the potential consequences of an economic slowdown, which could exacerbate unemployment and thus social tensions.

For all Mr Hu's resolve in dealing with Mr Chen, he and his prime minister, Wen Jiabao, sometimes appear to lack determination when it comes to steering the economy. Unlike his predecessor, Zhu Rongji, who took considerable political risks to steer China into the World Trade Organisation in 2001, Mr Wen has made more concessions to a groundswell of economic nationalism. It is unclear whether he will heed an outcry from abroad over new regulations issued this month by Xinhua aimed at tightening its control over the distribution of news services in China by foreign agencies. This has been viewed as an effort by Xinhua to displace foreign companies such as Reuters and Bloomberg, which dominate the provision of financial news and information to Chinese banks and brokerages.

The shake-up in Shanghai might at least prompt new thinking about the chaotic management of China's social-security funds. These (apart from a centrally managed reserve fund) are currently in the hands of local officials who have a tendency to invest them rashly or to pocket them. The illicit flow of this money into real-estate ventures gives local governments all the more incentive to pump up property prices. *Shanghai Daily*, a state-run English-language newspaper, quoted an official as saying that from next year the funds might be supervised centrally and entrusted to “independent fund managers”. That is long overdue.

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Japan

The A team

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A new prime minister picks his cabinet

HAVING won the race for the presidency of the ruling Liberal Democratic Party (LDP) a week earlier, Shinzo Abe on September 26th was duly elected by parliament to succeed Junichiro Koizumi, the prime minister since 2001. As Mr Koizumi bowed out, Japan's new leader swiftly announced his government.

Those inclined to view Mr Koizumi's iconoclastic years as an aberration from Japan's normal political course may find confirmation in Mr Abe's appointments. Prominent are party hacks who helped Mr Abe to the LDP presidency—Mr Koizumi remained aloof from his backers—while spoils have also been handsomely distributed among the party factions that Mr Koizumi rather hoped to destroy. Thus Koji Omi, a 73-year-old who was an early and vigorous supporter of Mr Abe among a generation that initially disdained him, has been made finance minister; he is no pro-market reformist, though probably in favour of balancing the books. In all, four members of the Mori faction (the party's biggest, to which Mr Abe had belonged) were awarded cabinet posts. The Niwa-Koga faction was thanked for its support with four positions, including a job for Hakuo Yanigasawa, a hapless finance minister under Mr Koizumi, and Sanae Takaichi, who thinks war criminals should be honoured at the Yasukuni shrine and who deplores the right of married women to keep their maiden names. She is the minister for gender equality.

The style of these appointments has disheartened pro-market reformers. Yet while admittedly rewarding party factions and older politicians, Mr Abe has also put vigorous reformists into key posts. In particular, Yasuhisa Shiozaki, a former Bank of Japan official and close ally of Mr Abe, has the crucial job of chief cabinet secretary—the position that Mr Abe held until this week. Staunchly pro-market, Mr Shiozaki thinks that even Mr Koizumi's radical reformer, Heizo Takenaka, who is considered by Mr Abe to be too obviously associated with the Koizumi reforms, grew soft; he is loathed by bureaucrats for his cockiness. In addition, Mr Abe has made an academic, Hiroko Ota, a protégé of Mr Takenaka, economy minister. She will steer the Council on Economic and Fiscal Policy, the main policymaking body.

Mr Abe has also moved to centralise authority within a traditionally weak prime minister's office, by creating teams of advisers to hammer out economic and security policy—his models are America's National Economic Council and National Security Council, respectively. Here, too, he has appointed bright, practical minds: notably Takumi Nemoto, another ally, who is responsible for economic policy. Mr Abe has sought to thwart any moves by the party to undercut him by making secretary-general of the LDP the other of Mr Koizumi's two key former reformers, Hidenao Nakagawa, the new prime minister's strongest backer. It all suggests an emphasis on more policymaking, not less.

As for foreign affairs, Mr Abe looks set, unsurprisingly, to count on fellow conservatives like himself. Yuriko Koike, a 54-year-old former journalist who fills the new post of national security adviser, has been a staunch advocate of placing sanctions on North Korea for its refusal to provide details of Japanese citizens abducted in the 1970s and 1980s. Taro Aso, who lost to Mr Abe in the fight to lead the LDP, remains foreign minister. Mr Aso backed Mr Abe in pushing for international sanctions against North Korea after it loosed off missiles in July. But he is also seeking an emollient early summit with China.

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Thailand

A stormy start

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The junta's stumbling first steps

Reuters

THE storms that lashed Thailand this week were a fitting Shakespearean metaphor for the kingdom's troubles. A week after a coup by six top military men overthrew the government of Thaksin Shinawatra, the streets remained calm. But the generals were still struggling to find a suitable statesman to head the civilian administration to which they have promised to hand power by October 4th. To soften its image, the Council for Democratic Reform, as the junta calls itself, has appointed various advisory bodies, stuffed with Thailand's great and good. However, several of them have complained that the generals announced their names without asking them if they wanted to take part.

The generals were stung by criticism of the coup by foreign governments and human-rights bodies. The United Nations' human-rights chief, Louise Arbour, condemned their restrictions on free speech and freedom of assembly. In a meeting with foreign ambassadors this week, the junta reportedly asked them not to see only the “dark side” of the coup, but to give them a chance to keep their promise to restore democracy.

It seems they intend to restore it only up to a point. The civilian prime minister will choose his own cabinet. But the junta will continue to “assist” the new government in running the country, said one of its members, General Winai Phattiyakul. The generals will select an interim National Assembly and they will also have a strong hand in choosing a body to draft a new constitution.

Indeed, the “civilian” prime minister may turn out to be a military man. An early, strong favourite for the job was Supachai Panitchpakdi, a former deputy prime minister who now runs the UN's trade and development agency. But he was said to be resisting the generals' pleas to take the job. Fishily, in mid-week, General Sonthi Boonyaratglin, the army chief and junta leader, started mentioning that retired military officers were also civilians.

This prompted speculation that one of his predecessors, Surayud Chulanont, was in line for the job. Mr Surayud, now an adviser to King Bhumibol, had a reputation for cleaning up corruption in the armed forces. He would command widespread respect in Thailand if chosen. But he may not be the right man to stand up to his former comrades if the junta tries to meddle in the interim government's affairs.

The generals have drafted a temporary constitution, to remain in force until a permanent one has been written and put to a referendum. They were planning to ask the king to approve it on September 30th. Academics shown the draft were pleased to see it affirmed basic rights, including press freedom. But it remains to be seen how soon and how fully the junta will lift its ban on political gatherings. Several small anti-coup protests, held in central Bangkok in defiance of the ban, were ignored. If they get bigger, the generals' patience will be tested.

The sight, in recent days, of Bangkok citizens welcoming the soldiers on their streets is reminiscent of Thailand's last coup, in 1991, says Thitinan Pongsudhirak, a political scientist. That coup was popular at first, for overthrowing a government widely seen as corrupt, like Mr Thaksin's. But public opinion

changed drastically as the army clung to power. Rising protests and, eventually, bloodshed ensued. History could repeat itself, worries Mr Thitinan. Some opponents of Mr Thaksin, while welcoming his downfall, opposed the coup. If the generals are heavy-handed, they could find themselves ranged against an unholy alliance between the opponents and supporters of the deposed prime minister, says Mr Thitinan. However, the generals have little choice but to keep a hand in guiding the country through its crisis, since they stand to be blamed if it all goes wrong. Striking the right balance will be hard.

The generals have shown some degree of political savvy: they promise that several of Mr Thaksin's most popular programmes, including cheap health-care and a micro-loans scheme to cut rural poverty, will continue. An expansionary budget is being prepared, to help the Thai economy ride out the political storm. These policies should reduce the chances of a backlash by Mr Thaksin's supporters in the countryside. The big investigations that have been started into corruption in the Thaksin government may sap support for the deposed leader and his Thai Rak Thai party, reducing their chances of a comeback. But they will not eliminate them: Mr Thaksin, exiled in London, will be hoping that the army forces, and their civilian appointees, make such a mess that one day he will be welcomed back, his sins forgiven.

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Pakistan and Afghanistan

A border war

Sep 28th 2006 | LAHORE
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Pervez Musharraf and Hamid Karzai bicker in America

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THE food was good, but not the mood. On September 27th General Pervez Musharraf, Pakistan's leader, and Hamid Karzai, his Afghan counterpart, met for dinner with George Bush in Washington. This feast, of soup and sea bass, followed weeks of feuding between the two neighbours, both key American allies in the war on terror. Afghanistan, and the western NATO powers trying to pacify it, accuse Pakistan of succouring, or at least suffering, the Taliban who have found refuge in its northern tribal areas. Mr Karzai accuses General Musharraf of “keeping and training snakes”. The general says Mr Karzai's weakness underlies the Taliban's strength. Before the dinner, which appeared to do nothing to ease the troubles, General Musharraf said smilingly: “Mr Karzai is the best man for Kabul,” then added, “but he doesn't understand Afghanistan.”

The dispute has fixed on a deal agreed on September 5th between General Musharraf and, it is alleged, the Taliban to keep the peace in Pakistan's tribal region. He says the deal was with 45 “tribal elders” in the border area of North Waziristan, and stipulated that local al-Qaeda fighters must be expelled and that the Taliban must not rule the place or do violence across the border. In return, he promised the locals that troops in the area would ease border checkpoints, in effect granting the tribes licence to smuggle. The government would also release dozens of militants—and provide lots of cash. Pakistan has said it will not withdraw its troops from the border, and may again attack the militants lurking there. But on the day General Musharraf met Mr Karzai in Washington, the Taliban was reported to have opened two offices in Miran Shah, capital of North Waziristan. An American official in Kabul also leaked the news that Taliban attacks in southern Afghanistan have increased threefold since Pakistan's deal with the tribes.

This has put General Musharraf on a sticky wicket with America too. But, at least in public, Mr Bush said he was content that the general was doing his best to quell the Talibs. Indeed, the pact with the elders, if that is what they were, followed the failure of an American-sponsored effort to control the region by force. During America's 2001 invasion of Afghanistan, hundreds of al-Qaeda fighters, likely including Osama bin Laden, and thousands of Taliban, crossed the border into the semi-autonomous tribal area. So General Musharraf, for the first time in Pakistan's history, sent his army in. For two years, it has taken a beating. Several hundred soldiers have been killed; the local, always fragile, civil administration has been practically dismantled; and the militants' ability to skip across the border has been undiminished. Indeed,

laden with Afghan drug money, they have grown stronger, igniting a war with British and Canadian NATO troops in southern Afghanistan.

If General Musharraf's peace deal with the tribes was an admission of his army's defeat, he will not own to it. He calls it a breakthrough in the campaign against the Taliban, and a possible template for peacemaking in Afghanistan. In Kabul earlier this month, he told Mr Karzai that he would help him to “crush the Taliban who are more evil than even al-Qaeda”. On his return home, a little provocatively, he then stated that there were no Taliban operating in Pakistan.

This has annoyed Mr Karzai. Like most Afghans, he resents Pakistan for having sponsored the Taliban while they ruled his country, and thinks it supports them still. Before the frosty dinner in Washington, he told a think-tank crowd that he and General Musharraf “both knew that Taliban leader Mullah Omar and Osama Bin Laden were in Pakistan for sure”.

He, and perhaps Mr Bush, are not the only ones losing patience with Pakistan's military ruler. Indeed, with the notable exception of the American publisher of his memoir, “In the Line of Fire”, which was launched on September 26th, he is fast losing friends. Indians are bristling at the book's treatment of their former prime minister, Atal Behari Vajpayee, and current prime minister, Manmohan Singh, who are portrayed as sincere but weak. General Musharraf, incorrectly, taunts India for losing a war with Pakistan at Kargil in 1999. In Pakistan, powerful mullahs, and many others, accuse him of cowardice for bowing to America's demands after the 9/11 attacks—he says that Richard Armitage, the then deputy secretary of state, threatened to “bomb Pakistan into the stone age”.

In Britain, meanwhile, an official, intelligence-based report described Pakistan as on the verge of chaos. It accused the powerful spying agency, ISI (Inter-Services Intelligence), which brokered the deal in North Waziristan, of indirectly supporting terrorists.

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Bangladesh

Too busy to trade

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Elections inspire economic nationalism

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FOR a poor country, starved of energy and capital, where integration with the global economy, especially through its clothing industry, has lifted millions from rural misery, Bangladesh has seemed remarkably cavalier towards the billions of dollars in foreign investment that have recently been on offer.

The country's desperate needs were illustrated this week by violent protests in Dhaka over dire power shortages, the worst since the government, a coalition led by the Bangladesh Nationalist Party (BNP), came to power almost five years ago. The economy has grown by more than a quarter since 2001, but power-generating capacity has not increased. The ruling coalition, which is due to step down on October 27th in favour of a caretaker government that will oversee elections in January, does not seem bothered. In recent months it has turned its back on more than $4 billion in foreign investment—considerably more than the country's existing stock of foreign direct investment.

Short of domestic sources of capital, Bangladesh needs foreign capital to fulfil the government's goal of halving the number of poor people by 2015. But politics has stood in the way. Last month, the government called off a $1.4 billion coal project agreed with a British-based company, Asia Energy, after the police had shot dead at least five demonstrators at the site of a proposed open-pit mine in north-western Bangladesh. Widespread protests, backed by the main opposition party, the Awami League, forced the government to promise to meet the demonstrators' demands: to cancel its agreement with Asia Energy and ban open-pit mining.

The project, which would have extracted 15m tonnes of coal a year, was controversial. It required the relocation of at least 50,000 people—in the world's most densely populated country. But the ban on coal mining perpetuates one of the economy's weaknesses: its inability to meet its growing energy needs.

Even this fiasco is overshadowed by the government's inability, after almost two years of negotiation, to conclude a $3 billion coal, steel, gas and fertiliser project, promoted by the Tata group from India. Bangladesh's aid donors are in favour. They say it would bring power and development to Bangladesh's poor north-west, plenty of foreign currency and new sources of energy. Negotiations have stalled, however, ostensibly over the difficulty of agreeing the price of the gas needed as fuel. More likely, widespread anti-Indian sentiment has given the government cold feet ahead of the election.

The government's claim to be protecting Bangladesh's natural resources from greedy foreigners has proved popular. But without heavy foreign investment the economy will find it hard to support the growing population. By the middle of the century, Bangladesh, which is only twice as big as Ireland, will have 243m people.

But, for now, electoral politics drive economic policy. Last week, a visiting mission from the European Union urged the two main parties at least to co-operate over the poll. Impasses over the formation of the caretaker government and the election commission may lead to an opposition boycott. But both sides are wedded to a tradition of not co-operating. In Bangladesh's elections, the winner takes all.

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Tonga

The king is dead

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His successor might consider lobbing a little power to his people

HE MAY not inherit everything from his father. But King George Tupou V, Tonga's new monarch, who has been sworn in, but not formally crowned, following the death of the battleship-sized King Taufa'ahau Tupou IV on September 10th, already has a picturesque palace, the royal title and a good deal of respect from his 110,000 subjects in Tonga. The big question is whether he will bow to the pleas of the country's growing pro-democracy movement, and limit his throne's huge powers.

That was not to the dead king's taste. In May last year, 10,000 Tongans took to the streets to demand democracy, but in vain. On his sickbed, in a hospital in New Zealand, the king was handed an official report on Tonga's options for political reform; he died soon after from heart trouble.

At the king's funeral in Tonga, on September 19th, military bandsmen in white pith helmets played British marching tunes, as the king's body was transported to the Mala'e kula burial ground. B-list foreign dignitaries, including Britain's Duke and Duchess of Gloucester and Japan's crown prince, attended. Perhaps they failed to notice the gaggle of pro-democracy activists outside the royal palace, holding banners proclaiming: “The will of the people is the basis of government.” But after a month of national mourning, these folk may get a wider hearing.

Unlike his royal father, the new king played a modernising role in recent years. As a result, the country now has its first “commoner” prime minister for a century, Fred Sevele, and the cabinet looks increasingly reformist. The king has said he will divest himself of his big investments in the electricity, brewing and mobile-phone industries. He might do well to divest himself of some of his father's untrammelled powers too.

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Iraqi Kurdistan

Who is to control Kurdish oil, and protect it from sabotage?

Sep 28th 2006 | ARBIL
From The Economist print edition

Reuters

The Kurds say they will; the central government in Baghdad begs to differ

Get article background

IRAQ'S Kurds like to describe themselves as the orphans of history and geography. In the carve-up of the Ottoman empire after the first world war, they found themselves welded to a state in which they never felt at ease, stuck in the toughest of neighbourhoods. Nor has geology been the blessing that it might have been. Rather than benefit from the oil that swills under their northern homeland, Kurds argue that they have often been its victim.

Under Baathist rule, the Kurds were frozen out of jobs in the oil industry, while thousands of families were forcibly removed from their homes and land round the oil-rich city of Kirkuk. This lingering sense of injustice at the hands of the central government formed the backdrop to an extraordinary briefing last week about oil prospects in the region, given by Kurdish officials to a group of international energy executives in London.

Iraq is thought to have plenty of undiscovered oil but the insurgency and legal uncertainty have made companies wary of looking for it. Now, proudly waving a new petroleum law that is set to pass through the Kurdish regional parliament in Arbil in October, Ashti Hawrami, the Kurds' new minister for natural resources, told the gathering that the Kurdish Regional Government (KRG) had the authority to exploit any new oil and gas reserves discovered in the self-rule zone. It was the Kurds' intention, he said, to manage jointly with the central government any existing energy resources in areas that either fall within the KRG's current boundaries, or will do so should the Kurds succeed in extending their proposed federal region in a referendum due at the end of 2007.

Although northern Iraq's oil reserves are not as big as the giant southern fields round Basra, Mr Hawrami said the area had “good potential”, estimating reserves at around 45 billion barrels of oil and 100 trillion cubic feet of natural gas. He also held out the prospect of a second export pipeline from Kirkuk to the Turkish port of Ceyhan, which would run through Kurdish-controlled territory, thus giving it greater protection from sabotage attacks.

Mr Hawrami assured his audience that his plans were in keeping with Iraq's new federal constitution and

would be legally enforceable. Until now, only small, independent explorers have set up in the Kurdistan region. The KRG has signed production-sharing contracts with a Norwegian oil company, DNO, which is already drilling for oil near Zakho, and with Turkey's PetOil and Genel Enerji, which is exploring near Taqtaq. Memoranda of understanding have been signed with other independents, and Mr Hawrami said that the KRG was set to sign further production-sharing contracts in October, and was also talking to several oil majors. Revenues would be shared according to the law, he said, stressing his co-operation with the central authorities.

Not so fast. No sooner had Mr Hawrami spoken, than his counterpart in Baghdad, the federal oil minister, Hussein Shahristani, appeared to pull the rug from under his feet, telling the state-owned *al-Sabaah* newspaper: “The ministry isn't committed to oil investment contracts signed in the past...by officials of the government of the Kurdistan region.”

Mr Shahristani, who has the support of the ruling Shia alliance, insists that contracts signed without the approval of the central government should be nullified and that all the country's oil exploration, production and export contracts should be placed in the hands of his ministry in Baghdad. Any new energy contracts should wait until Iraq produces a new hydrocarbon law, possibly sometime in the new year. Oil officials in Baghdad have hinted at blacklisting companies that currently work in Kurdistan.

This tussle between Baghdad and the Kurds over control of Iraq's northern energy resources is also alarming the country's Sunni Arab minority. Many Sunni leaders believe that the decentralisation of Iraq's oil, as envisaged in the constitution, is the latest example of a conspiracy to break Iraq into three parts: a Kurdish north and a Shia south, both of them rich in oil, and a revenue-starved Sunni centre.

This week their simmering concerns boiled over on the floor of parliament as members of the largest Sunni block, the Sunni Accordance Front, denounced some of their leaders as traitors for agreeing to a deal over a Shia-proposed bill to put flesh on the federalism enshrined in the constitution. The deal, which allowed the federalism bill to be read in parliament, also allows for a committee to consider amending the constitution.

Sunni politicians are banking on amendments that will dilute the constitution's federal provisions. They have all-but accepted the Kurds' autonomy—though not their attempts to develop their natural resources—but are vehemently opposed to the creation of a powerful Shiastan in the south. Yet any constitutional amendment must be approved in a referendum of all Iraqis. And it is unknown whether a sufficient majority of Shias and Kurds will say “yes” to a dilution of federalism.

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The West Bank

Hamas makes the best of things

Sep 28th 2006 | BEITA AND QALQILIYA
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Though Hamas is under siege, at the local level it is doing rather better

LIKE every Palestinian town, Beita, a dusty home for 10,000 people spread across a hillside in the middle of the northern West Bank, has seen its fortunes dive since the start of the second *intifada* in 2000. Never prosperous, reliant on the wages of labourers who worked in Israel, it now has around 65% unemployment.

Yet since coming to office in December 2004, Arab Asharafa, the town's engaging and energetic mayor, has achieved something of a turnaround. He has widened the main road running through the town, is landscaping a new public park and opened a fruit and vegetable market that brings the council $100,000 a year in revenues (the market has gained at the expense of tightly-restricted Nablus, which used to be the main trading hub for the region). He has even started a project to bottle water from the town's spring and sell it, perhaps for export to Jordan.

What makes this remarkable is that the Beita council is dominated by Hamas, which ousted Fatah from the Palestinian Authority (PA) in elections this year. Well before the world's economic boycott of the PA began in March, foreign funding to local councils had begun drying up as Hamas took them over. Beita used to get 30-40% of its revenues from abroad, says Mr Asharafa; now it gets none.

Instead, Beita, under its Hamas mayor, provides an example of how Palestinians might start to wean themselves off donor-dependence. Its success comes partly because, while at the national level Fatah and Hamas are at loggerheads (talks on a national unity government, which seemed a done deal two weeks ago, are now stalled again), in Beita, as in many other mixed local councils, they co-operate.

It is also due to Mr Asharafa's mixture of charisma and creative thinking. He cracked down on electricity theft and non-payment of utilities bills while giving amnesties to students and the unemployed. He saves money by buying bulldozers and reselling them at the end of a project, instead of hiring. He talks businessmen into investing in public projects and taking a cut of the proceeds; at one point, he offered to put his own house up as collateral.

Politically, too, Mr Asharafa can permit himself statements that Hamas's senior leaders cannot. “Hamas must make peace with Israel,” he says, claiming that 90% of Palestinians want a two-state solution, and that the main obstacle—and reason why Hamas will not take the step of recognising Israel outright first—is a lack of trust.

AFP

Qalqiliya carries on

Another northern town, Qalqiliya, is in a much tougher position than Beita. It used to flourish as a way station on the once-invisible border between the West Bank and Israel but has fallen into a dead zone with the construction of Israel's "separation barrier". The wall or fence surrounds it entirely, leaving only one permanently open road in and out, and carving the town off from 83% of its municipal territory—mostly farmland, to which its owners have only restricted access. The council, which unlike Beita's is entirely Hamas-run, has also been accused of promoting or condoning religious intolerance. On top of that, only this month was the mayor released after 44 months in jail (from where he campaigned and won the election).

Yet even Qalqiliya's council has found money, thanks largely to the inefficiency of its Fatah predecessors: it has raised 5m shekels ($1.2m) just by collecting unpaid debts. The town's central park is being spruced up into an "entertainment city" for children, with a miniature train, bumper cars and a ferris wheel, and new enclosures are being built for the larger animals in the occupied territories' only zoo (Israeli forces destroyed the one in the Gaza strip in 2004). Next to it huddles a newly built area containing a botanical garden and a set of small museums—archaeology, geology and natural history.

It is the last of these that best shows off the Palestinians' knack for making the best of a bad situation. During the *intifada*, as clashes raged near the zoo, many animals died from exposure to tear-gas. Someone was resourceful enough to have them stuffed, albeit somewhat inexpertly. Now, with the museum recently opened, what began as a response to a tragedy has been made official zoo policy: every animal that dies becomes an exhibit.

So it is that frozen monkeys grace fake boughs, an ostrich stares forever into the distance, and, in a savannah scene, a slavering hyena drips plastic blood over the corpse of a zebra, under the gaze of an angry bear and a placid lion. The lone giraffe that ambles forlornly around its enclosure outside might, if it were able to, take comfort from the knowledge that it will one day be reunited with its preserved—if slightly bug-eyed—partner.

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Egypt and nuclear power

Nuclear succession

Sep 28th 2006 | CAIRO
From The Economist print edition

Why Egypt's unofficial crown prince has staked his country's claim

AP

Gamal Mubarak rubs up his image

WHEN Gamal Mubarak, the son of Egypt's president, announced his country's intention to pursue atomic energy, the message was hardly a bombshell. As long ago as the 1970s, Egyptian leaders declared that dwindling oil reserves would make nuclear power a necessary option. But both the timing of the initiative, and its messenger, were significant, for the wider region as well as for Egypt.

Egypt is the most populous, culturally prolific and strategically situated Arab country. Yet in recent years its political clout has diminished. This is partly a result of its poverty, compared to the oil-rich Gulf states, and partly because Hosni Mubarak's 25-year rule has been marked by too-close ties with an increasingly discredited America. In exchange for $60 billion in American aid, Egypt has given quiet but crucial military and diplomatic backing to America's regional policies.

The regime's critics are sure that the 78-year-old president, who was re-elected to a fifth six-year term last year, wants his son to succeed him. Associates of the younger Mubarak vigorously deny this claim, pointing to his limited official title as the head of the ruling party's policy secretariat as a sign of modest ambitions.

Until recently, it is true, Gamal's influence was most apparent in a shift towards more liberal economic policies, the economy being a realm traditionally viewed by Egypt's security-obsessed establishment as secondary to such “sovereign” matters as defence and foreign affairs. But by announcing Egypt's nuclear-power drive at a party conference, during a period of high regional tension over Iran's nuclear ambitions, the younger Mubarak was clearly staking out a more assertive role, both for himself and for Egypt.

Egypt's decision to pursue nuclear energy is not in itself controversial. The country is, unlike neighbouring, and nuclear-armed, Israel, a signatory to the Nuclear Non-Proliferation Treaty (NPT). Nuclear power makes fairly good economic sense. Building reactors, such as the 1,000 megawatt unit Egypt plans to develop west of Alexandria, is expensive, but subsequent operating costs are low and stable, and increasingly competitive as fossil-fuel prices rise. Egypt currently gets most of its electricity from natural gas and has large reserves, but there is a cost in burning the stuff at home when it could be exported.

Besides, Egypt is not alone in starting to think nuclear. Earlier this year, Turkey announced plans to build three nuclear power plants by 2015. Morocco and even impoverished Yemen also say they are interested. In an oil-drenched region, all these countries are united by the relative scarcity of their energy reserves.

This is not so with Iran, which is far ahead in the nuclear game. With similar populations, Egypt and Turkey are Iran's historic rivals in the region. However sound the economic reasoning behind nuclear energy, their sudden interest in getting it is also prompted by fear and envy.

The fear, which countries such as Egypt share with Western allies, is that if Iran (which has been deemed in “non-compliance” with nuclear safeguards required under the NPT) develops nuclear weapons as well as power, it will start to throw its weight around. The envy is of the fact that Iran's controversial programme has made its regime more popular domestically, and brought it a certain respect, if only grudging, abroad. Thus a would-be-leader, such as Gamal Mubarak, gladly seizes on the issue to polish

his nationalist credentials.

But Egypt's initiative was meant to send a message in another direction, too. Like other Arab states, it has grown impatient over the West's perceived double standards regarding Israel's monopoly of nuclear weapons in the region.

At a little-reported session of the International Atomic Energy Agency last week, America and its allies joined together to block an Arab-Iranian resolution calling for Israel to join the NPT, and for the Middle East to be declared a nuclear-free zone. Egypt's foreign minister, Ahmed Abul Gheit, riposted: “For developing and Arab countries to comprehend the concern Western powers express over the Iranian nuclear issue, these Western powers have to convince everyone that they adhere to all that is lawful, and not pick sides.”

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Tanzania

Bye-bye poverty

Sep 28th 2006 | DAR ES SALAAM
From The Economist print edition

An African country that deserves the money it gets

DEVELOPMENT economists use it as a measure. If Tanzania can haul itself out of poverty, others can too. But if it cannot, there will have to be another rethink about the way that aid money is spent.

For the moment, Tanzania is one of east Africa's few good-news stories. That isn't saying much. The country remains wretchedly poor, inefficient, with little medical care in its remote areas, few roads and with frequent power cuts, even in Dar es Salaam, the largest city. But donors, disillusioned by the corruption and/or brutality that goes on elsewhere, are happy to pour money into somewhere that is, at least, both peaceful and stable.

And in Jakaya Kikwete, Tanzania has found a president committed to doing his best to cut poverty. A long-serving former foreign minister, Mr Kikwete was elected in December with 80% of the vote. He remains hugely popular.

He is helped by the efforts of his predecessors, particularly the sturdy Benjamin Mkapa. The country's GDP growth is expected to be 5.8% this year, rising to 6.7% next year, and inflation has been low for years. Tanzania's relative lack of graft means that some donors now put their money directly into the national budget with few strings attached. Britain hopes to deposit $170m a year into Tanzania's coffers in this way for the next few years—just the kind of predictability of giving that the aid community has called for.

The question is whether the Tanzanian government will be able to spend the money wisely. Prioritising is difficult. For instance, it takes Mr Kikwete over an hour, in an interview, just to outline the basic needs: more schools, universities and hospitals; more roads. Mr Kikwete's party, Chama Cha Mapinduzi (CCM), has set ambitious targets for all these shortages. Lack of clean water is a particular worry. “It tortures our women,” says Mr Kikwete, with feeling. CCM's manifesto calls for doubling the access to drinking water by 2010.

Overhauling the largely subsistence agricultural sector could be even more important. If yields can be increased through subsidised irrigation and fertilisers, and if peasants can diversify their production from maize, “we can say bye-bye to poverty,” promises Mr Kikwete. That is an old tune—agronomists have been humming it since the 1960s. But this time the plans are backed by road-building schemes, new technologies, market mechanisms and, just possibly, enough donor money to underwrite the subsidies.

Much also rests on how CCM performs. The party has dominated national politics since independence, with disastrous economic results in the old days. It is no longer socialist—the old mantra of self-reliance is more of a sentiment than an ideology now—but nor is it yet a businessman's party. Though the past few years have brought in some foreign investors, especially in gold mining, there are few signs of the kind of innovative policies that might attract significant investment or lure back educated Tanzanians from abroad.

Still, CCM can take credit for Tanzania's strong sense of “togetherness”: it is a place where loyalty to the country often counts for more than tribal or religious identity. Mr Kikwete is an observant Muslim. The first president, Julius Nyerere, was a pious Roman Catholic; the church is considering him for sainthood. Togetherness may also explain why CCM remains as dominant as it still is: at last year's election, it won 202 of the 232 parliamentary seats.

Mr Kikwete travels with minimal security. He scrolls through several hundred text messages on his mobile phone each day, most of them from ordinary citizens who have somehow obtained his number.

Sometimes he texts back. He is clearheaded on international issues. He is happy to contribute three battalions to a prospective UN peacekeeping force in the Darfur region of Sudan, he says, so long as someone else foots the bill.

Perhaps the biggest reason for hope lies glittering below the ground. The government's demand for a bigger cut in revenues means that its relations with foreign gold-mining concerns are strained. But the country remains rich in deposits of gold and other minerals. Some reckon that there is $20 billion in nickel deposits alone, somewhere down there in the earth.

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Somalia and Kenya

Heading for the beach

Sep 28th 2006 | MALINDI
From The Economist print edition

The state of Islam on Kenya's Swahili coast

Raising the local temperature

ISLAMISTS strengthened their hold on Somalia this week, after capturing the southern port of Kismayo. Although they have no intention of crossing into neighbouring Kenya, the question is what effect their ascendancy will have on that country's predominantly Muslim coast.

Although Somalia's Islamists say that their aim is nothing more threatening than to remake the country as a peaceful and tolerant Islamic state, Somalia's internationally recognised (but dreadfully weak) transitional government insists that they are an “al-Qaeda network”. A recent suicide bombing which narrowly missed the transitional president, Abdullahi Yusuf, and the killing of an elderly Italian nun working at a Mogadishu hospital, probably in retaliation for Pope Benedict XVI's remarks on violence and Islam, confirmed the worst fears of some, including the United States. The Kenyan coast already has direct experience of al-Qaeda's brand of violence—in 2002 it bombed a hotel full of Israelis in Mombasa, killing 16, and tried to shoot down an Israeli airliner—and the Nairobi-based intelligence community expects more. So people are nervous.

Kenya's Muslims feel disenfranchised. They have had little access to national power, in contrast to neighbouring Tanzania, where Islamist rhetoric has been blunted by socialism and Muslims have held most of the high offices of state (see article). So far, however, Muslims on the Kenyan coast have usually been repulsed by jihadist rhetoric. But a revival of Arabic and access to Arab satellite television, linking local backwaters to a sometimes inflammatory message of Islam under siege, could change that.

Malindi is a case in point. The Muslim community there is taking steps to recover itself from what it calls the “corrosive” influence of tourism. The town's beaches have been a tidy earner since 1498, when Vasco da Gama was welcomed ashore. Things have got out of hand since. “The Italians have ruined this town,” says a Muslim elder. Several thousand Italians now live in Malindi and it is not just the Italian women wandering half-naked through conservative bits of the town that upsets local Muslims. It is the drugs and the sex tourism that the Italians have brought with them since taking over the tourism industry in the 1980s. Most of the drug users in the town are Muslim boys. Some become donkeys for cocaine traffickers; Malindi has become a shipment point for Colombian cocaine. Underage Muslim girls are lured

into prostitution. Tourists pay a premium for conservative girls: corruption is part of the thrill.

One reaction to this has been a growing opposition among the small but more Islamist Wahhabi community in Malindi. A more lasting reaction is what the more moderate Sunni elders call “awareness”—a renewed effort to raise up a generation of “pure” Muslims. Tahdhib school, in the centre of town, is pioneering a programme of “integrated education” which could spread along the coast. Children study the national curriculum in the morning and receive a Koranic education in the afternoon. No child can advance without passing exams in both secular and religious studies, and instruction is in English and Arabic. The teachers hope to produce both “good citizens of Kenya” and believers who will “close their eyes” to tourist excesses. Political discussion is avoided, although earlier this year the children were marched out to protest against Danish newspaper cartoons depicting the Prophet Muhammad.

Tourism is a soft target for jihadists and it has still has not recovered to pre-2002 levels. With its new mosques bristling against new casinos, Malindi feels vulnerable. “One bomb and it's over for us for another five years,” says a hotel owner. Maybe, but the real losers would be local Muslims who already struggle to get by in the long tourist off-season.

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Romania, Bulgaria and the European Union

We're off on a European odyssey

Sep 28th 2006 | BUCHAREST AND SOFIA
From The Economist print edition

Two poor countries celebrate joining the European Union. But the mood among existing members is glum

Eyevine

Get article background

FIRST the fake suspense; now the real work. On September 26th the European Commission gave the nod to Romania and Bulgaria to join the European Union next January (the decision must be endorsed by an EU summit, and four national parliaments still have to ratify it). Despite efforts to create an atmosphere of fingerwagging anxiety about both countries' patchy reforms, the outcome was never in doubt.

That is not because the two countries are ready—they are not. Although their economies are growing fast (by 7% in Romania, 6% in Bulgaria), both are poor, with incomes around one-third of the EU average—less than any of the eight other ex-communist countries that joined in May 2004. Romania, especially, has many poor farmers. More seriously, both countries are poor in public spirit as well.

Officials tend to be badly trained, ill-paid and often corrupt. For health care, bribes are routine. At Sofia airport, passport kiosks display “No Payment Here” signs in three languages. Every official is overlooked by a randomly chosen colleague. Not so long ago, border guards extorted small but tiresome bribes from visitors. Such things are distant memories in more advanced ex-communist countries.

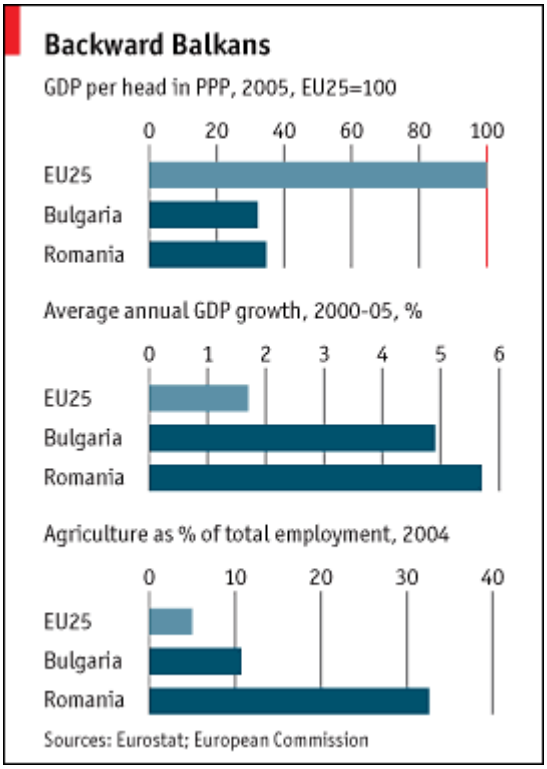
Romania is at least willing to prosecute corrupt politicians, thanks to a fearless non-party justice minister, Monica Macovei. In Bulgaria the process has barely begun. Three ministers from the same party are seen as especially corrupt. A foreigner with a big, troubled investment says of one: “My business will close if his ministry doesn't give me the permission I need. My lawyer keeps on getting phone calls offering to ‘solve’ the problem—and that involves either a bribe, or cutting one of the minister's friends in on the deal.”

In the previous government, a minister once said to an investor that “fences in this country can be high or low. The right friend can make them low. You should meet Mr Pavlov”, before

introducing him to a notorious gangster. The judiciary, autonomous to the point of lawlessness, is a big problem. One judge is nicknamed “servant” because of his docile bribability.

Such tales have given Bulgaria a bad reputation. Some are out of date: Ilya Pavlov was shot in 2003, one of scores of unsolved gangland killings. The prime minister, Sergei Stanishev, accepts that junior prosecutors may be corrupt but insists that top ones are not. Boris Velchev, the prosecutor-general, is both popular and respected. He has taken on a retired Dutch prosecutor as an adviser, asked parliament to strip a dozen deputies of their immunity, got rid of five senior colleagues and started investigations against at least six junior ones. In the past, he says, the prosecutor's office was a “nursery for corruption” and a “money printer”.

The worst corruption in both countries is in the customs service. Steve Keil, who runs Sciant, an IT company in Sofia, says a vital gadget was held up for months because customs officers deemed it to be “military cryptography”. “We just sent someone to Germany and he brought it back in his hand luggage,” he recalls. That should change after January. Polish customs officials were a big worry for business until 2004, when open borders with the EU sidelined them overnight.



Other efforts are less confidence-inspiring. Bulgaria's public-administration minister, Nikolai Vassilev, has sent 20,000 CD-ROMs with “self-study” anti-corruption software to local officials. That, he says, will at least tell them what's right and what's wrong. Many suspect that changes will be cosmetic because political will is lacking at the top. Mr Stanishev is known as “the lad” because real power lies not in the prime minister's office, but with two chiefs of his ex-communist party.

Bulgarians point out plaintively that corruption is a problem elsewhere too. Ognian Shentov, of the Centre for the Study of Democracy, a Sofia think-tank, argues that “corruption in Bulgaria is not necessarily the worst in the EU—but it is certainly the most intensively studied.” A realistic hope may be that it just becomes less blatant and less damaging: “Italian-style”, says one optimistic official. Indeed, if the EU can cope with Sicily, why not Bulgaria?

In recognition of these problems, Brussels has imposed a string of safeguard clauses on the two new members. It can step in if either country backslides, for example to cut subsidies if they are poorly or corruptly administered. Bulgarian court judgments will be recognised abroad only so long as judicial reform continues. Both countries must make six-monthly reports about corruption.

Most of the eight ex-communist countries that joined in 2004 were not ready either. Even today, their poor public administration creates problems in managing cash from the EU. But they are improving. And the stability and prosperity that has spread across the first eight is now the best argument for welcoming the Balkan pair. Their arrival extends the EU's borders round the troubled and troublesome western Balkans, and as far as the Black Sea—a region where the EU has strong interests on issues from energy to smuggling.

Among existing members, the biggest fear is over free movement of workers. The accession of the previous eight led as many as 2m people, chiefly Poles, Slovaks, Latvians and Lithuanians, to head west. Could that happen with migrants from the Balkans? Probably not. For a start, some 2m Romanians already work abroad, mostly in Italy and Spain. If they move out of the shadows, that means fewer problems, not more. In Bulgaria, “those who want to leave have already done so,” says Mr Stanishev. One nagging worry is migration by ethnic kin from two poorer neighbours. Romania sees most Moldovans as potential citizens; the country was a Romanian province until 1940. Bulgaria, with less justification, feels the same about Macedonia. Moldovans and Macedonians have been queuing up to get passports but are blithely blocked by what are called “administrative”—ie, illegal—means.

Most existing EU countries will impose restrictions on Bulgarians and Romanians—even Britain, Ireland and Sweden, which did not do so for the May 2004 entrants. The mood in Brussels is souring. This week the commission president, José Manuel Barroso, said it would be unwise to continue expansion until the EU's institutions are reformed. He may be misreading public opinion: enlargement has more support than

the Dutch and French showed last year for the EU constitution.

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Poland's government

Tangled and taped

Sep 28th 2006 | WARSAW
From The Economist print edition

Central Europe's political ructions spread to Poland

Reuters

RICKETY, ineffectual and quarrelsome, Poland's coalition has broken apart. If it cannot be glued back together, an election will be held, probably on November 26th. The government lost its majority when Jaroslaw Kaczynski, twin brother of the president, prime minister and leader of the main party, Law and Justice, sacked Andrzej Lepper, who leads the second-biggest coalition party, a leftist agrarian bunch called Self-Defence, for insisting on higher social spending.

Mr Kaczynski had hoped to tame the rumbustious Mr Lepper in May, when he made him deputy prime minister in charge of agriculture and rural development. For a time, a sniff of power gave an unlikely veneer of respectability to a party known for its stunts, sleaze and sensationally impractical policies. But Mr Lepper chafed. He was particularly miffed not to be consulted about the recent despatch of extra Polish troops to Afghanistan.

The prime minister's fallback plan is to split Mr Lepper's party. He has won over eight deputies from Self-Defence, but that is not enough for a majority. On September 26th Polish television broadcast two taped conversations of separate members of Mr Kaczynski's party trying to win over a Self-Defence deputy by offering her a senior job (“we've got lots”). Opposition parties screamed about a big scandal; Law and Justice responded laconically that “politics is dirty”.

And how. Mr Lepper's deputies have signed IOUs to the party for the equivalent of $177,000, cashable if they switch sides, an unorthodox approach to party discipline that may be illegal. Mr Kaczynski has other possible plans. One is to win over the Peasants' Party, but its leader, Waldemar Pawlak, does not trust him. Attempts to poach deputies from Civic Platform, Law and Justice's centre-right rival and former ally, have failed.

At least the economic situation is not as bad as in Hungary. One difference is that Poland's finances are solid. The country's currency and credit ratings are firm. Annual GDP growth is a buoyant 5.5%, the budget deficit is shrinking and the current-account deficit is less than 2%.

If he cannot find a new majority, Mr Kaczynski may have to concede an early election—barely a year after the previous one. His record is not awful, but it is lacklustre. The government has been energetic over reforms in defence, the intelligence services and criminal justice. But it has been ineffective in reforming the state bureaucracy and in using EU money to build better roads and more houses. And it has been dreadful on foreign policy.

The most likely outcome of an election, if one were held, is that Law and Justice and Civic Platform would win 25-30% of the vote apiece, and Self-Defence would be the only other party in parliament. Poles seem to want a reformist conservative government. Their politicians are oddly unwilling to provide one.

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Switzerland and immigration

Tilting at windmills

Sep 28th 2006 | GENEVA
From The Economist print edition

A successful populist attack on Swiss asylum and immigration laws

SOME three years after he joined the government, Switzerland's right-wing justice minister, Christoph Blocher, has finally made a mark. Around 68% of voters endorsed his tightening of asylum and immigration laws in a referendum on September 24th. That reverses a narrow defeat for Mr Blocher and his Swiss People's Party (SVP) in a referendum in 2002, when just over 50% of voters rejected an initiative to clamp down on “abuse” of asylum.

This time, the two other right-leaning parties in the government backed the new law. The main opponent was the fourth party, the Socialists, who decried the changes as “inhuman and inefficient”. Asylum-seekers in Switzerland now face faster repatriation and exclusion from welfare benefits unless they present an official identity document within 48 hours. Almost three-quarters of asylum-seekers do not have documents, says Mr Blocher, who suspects that many discard them to avoid proper investigation of their claims.

Besides the asylum changes, the referendum approved an updated law on foreigners. European Union citizens have a free crack at the Swiss labour market, but others are largely excluded, unless they have essential skills that cannot be found nearer home. The new law also incorporates a demand for integration into Swiss society, a requirement once confined to citizenship applications.

The existing immigration and asylum regime has shown little sign of being overwhelmed. The Swiss National Bank's president, Jean-Pierre Roth, says the economy enjoys near full employment—this week it was even rated the world's most competitive by the World Economic Forum. Switzerland once had one of the highest shares of asylum-seekers in Europe, but the inflow has declined sharply. In 2002 some 26,000 people sought asylum, says the UN High Commissioner for Refugees; last year the number was down to 10,000.

The impact of the new law still depends on its implementation. The requirement for identity papers will not apply for “excusable motives”, such as a refusal by the home country to provide them, or if the applicant shows evidence of persecution at home. Opponents vow to ensure these safeguards are respected.

Mr Blocher's party has blossomed in the past two decades by advocating isolation and portraying immigrants as a threat. Itis now taking aim at Switzerland's Muslims, fighting minarets, veils and other signs that “fundamental Christian and democratic values are imperilled”. This echoes the period before modern Switzerland (with its constitution protecting minorities and guaranteeing religious freedom) was formed. Lausanne once banned Roman Catholic churches with spires.

The SVP has another goal: to block aid for eastern European members of the European Union in a referendum on November 26th. The foreign minister, Micheline Calmy-Rey, a Socialist, argues that the money will help these countries to prosper, making it less likely that migrants will knock at Switzerland's door. By tradition, Mr Blocher must this time stay silent, as most of the cabinet back the law.

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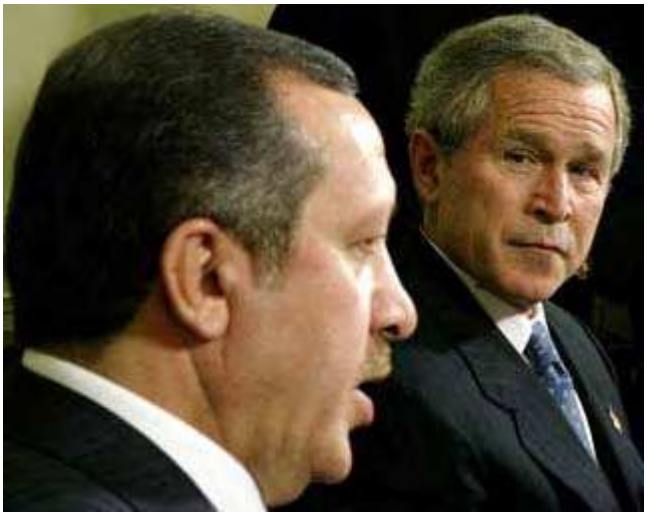
Turkey, America and Europe

The awkward partners

Sep 28th 2006 | ANKARA AND WASHINGTON, DC
From The Economist print edition

Growing worries in the West over the risk of losing Turkey

AS AMERICA ponders its options on Iran, Turkey figures prominently in its calculations. An old ally with NATO's second-largest army, Turkey may be the only regional power with any clout in Tehran. That is one reason why President George Bush is meeting Recep Tayyip Erdogan, the Turkish prime minister, at the White House next week.



George and his sometime friend

The trouble is that squabbles over Iraq have poisoned Turkish-American relations. According to a recent survey of transatlantic trends carried out by the German Marshall Fund, Iran is over twice as popular among Turks as America is.

At the same time, rows over Cyprus may soon lead to the suspension of Turkey's membership talks with the EU. This week the European Parliament adopted a report that criticised Turkey for its human-rights failings. Since support for EU membership has fallen to just 50%, from a high of 84% two years ago, few Turks may care.

Indeed, pandering to a resurgent nationalism, Mr Erdogan is balking at EU demands to scrap Turkey's notorious article 301 that has permitted the prosecution of such novelists as Orhan Pamuk and Elif Shafak on charges of “insulting Turkishness”. Their acquittals have not deterred the Turkish Jurists' Union from pressing similar complaints against others.

Relations may worsen again when the pope visits Turkey in November. Islamist groups have said he should be arrested for quoting a Byzantine emperor's unflattering remarks about Muhammad. One Turkish columnist even suggested he should be killed. And all this comes just a year after Mr Erdogan's government triumphantly opened membership talks with the EU.

“The consequences of a rupture of ties between Washington and Ankara, or more darkly a Turkey that becomes strategically disoriented, would be great,” says Richard Haass, president of the Council on Foreign Relations. Although Turkey's flirtation with Russia, Iran and Syria does not presage a shift in its pro-Western stance, it cannot be taken for granted. Yet some EU politicians seem oblivious to the danger of “losing” Turkey. They are playing on public fears of letting in a poor, populous and mainly Muslim country. Such attitudes have reinforced Turks' conviction that the EU is a “Christian club”.

In Washington, Turkey's threats to carry its battle against Kurdish PKK fighters into northern Iraq are also concentrating official minds. Turkey has long demanded that America fulfil its pledges to act against some 5,000 PKK fighters based in the Kurdish-controlled enclave. The Americans cannot open a second front when their forces are stretched in the rest of Iraq. But they won't let Turkey do the job, because such an intervention would destabilise the only peaceful part of the country.

The Americans' stance is the biggest source of their new unpopularity in Turkey. With every new casualty at the PKK's hands, pressure increases on the government to pursue the rebels into Iraq. Should they do it, they may find themselves fighting not only the Kurds, but the Americans as well. Turkey's EU ambitions, once the best guarantee against any such intervention, can no longer be counted on.

Can the meeting with Mr Bush make a difference? No, say Mr Erdogan's critics. The meeting was Mr Erdogan's idea, and its real purpose, say these critics, is to burnish his image as a world leader who commands America's respect. Their cynicism is echoed by conservatives who blame Mr Erdogan for the chill with America.

In truth, attitudes in America have been hardening ever since 2003, when Mr Erdogan failed to use his party's big majority to pass a bill to allow American forces to use Turkey as a launching pad in the war on Iraq. The Americans later arrested 11 members of a Turkish special unit in northern Iraq for allegedly plotting to murder an Iraqi Kurdish politician. By the time they were released, anti-American passions had erupted within Turkey's once staunchly pro-American armed forces too.

What angers Bush administration officials is that, far from dousing the ensuing bout of America-bashing, Mr Erdogan and his party egged it on. Even pro-Turkish congressmen watched in horror as Mr Erdogan called Israel “a terrorist state” and Sunni insurgents who were killed in Fallujah “martyrs”. When Mr Bush met Mr Erdogan in June last year, many expected a showdown. Instead, the meeting marked the start of a climbdown, with both sides scrabbling for ways to turn their relationship around.

Next week's meeting is being held in the same spirit, insist officials on both sides. Mr Erdogan's decision to override public opinion and contribute some 1,000 troops to the UN peacekeeping force in Lebanon is an encouraging sign that Turkey's pro-Western orientation is intact. Turkey is also the largest supplier of non-combat equipment to American forces in Iraq.

On the American side the big reforms in Turkey, spurred mainly by Brussels, are starting to sink in. “For many years, this relationship [was conducted] between security elites”, observed Eric Edelman, now the number three in the Pentagon, and formerly America's ambassador in Ankara, adding, in an interview with a Turkish newspaper, *Radikal*, that “now, with a more democratic Turkey, you have to deal not just with elites but also with a broader public opinion.”

To demonstrate goodwill, the Bush administration has appointed a retired general, Joseph Ralston, as its “PKK co-ordinator”. But the general's role remains vague, and his assertion that military action against the rebels was “the last option” has not helped. “Most Turks see Ralston as window-dressing, as an attempt to buy time,” says Omer Taspinar, of the Brookings Institution. After three decades of fighting the rebels, many Turkish officials privately concede that they cannot win by military means alone. An amnesty that would allow PKK fighters to return home without risking prosecution would do much to help. So would lowering the 10% threshold for parliamentary seats that has kept out nationalist Kurds so far. The lack of representation has created a vacuum that is being filled by Islamic radicals in the mainly Kurdish provinces.

With Turkey's next election due to be held by November 2007, few believe that Mr Erdogan can now risk alienating nationalist voters by accommodating the Kurds. Recent opinion polls suggest that, although Mr Erdogan's party retains its lead, two of his right-wing opponents might get into parliament, along with the opposition Republican People's Party. A return to the sort of fractious coalition governments that paralysed Turkey for decades until 2002 could even allow the generals to reassert their influence. Breaking this vicious cycle will require courage and vision not only from Turkey's leaders, but from its allies too.

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Germany and Islam

A night not at the opera

Sep 28th 2006 | BERLIN
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A scrapped opera production mars an Islamic conference

TALK about bad timing. On September 27th the government opened a “German Islamic Conference” in Berlin. But it was swiftly overshadowed by the cancellation of Mozart's “Idomeneo” at the Deutsche Oper—apparently for fear of attacks by Muslim extremists. At the opera's end, the director has the protagonist, dressed in a bloody shirt, displaying the severed heads of religious leaders, among them Muhammad, to get over the message that enlightenment requires an end to religion.

The cancellation provoked howls from critics, who accused the management of self-censorship after vague warnings by the police. But the best director could not have dreamed up a better way of highlighting the task of the conference, which begins a process of dialogue meant to last two years: separating Islamic fundamentalism from Islam.

Until recently, German politicians have seen Islam as a security not a religious matter. After the failed terrorist attacks on trains this summer, they also realised that the country is not immune to Islamic terrorism (which may explain the cancellation of the opera).

More than 3m Muslims, mostly Turks, now live in Germany. Political leaders have come to accept that Islam is here to stay; hence the government's conference. “What can we do so that Muslims in Germany feel more like German Muslims?” asks Wolfgang Schäuble, the interior minister. He hopes to see the creation of an umbrella organisation that can be an interlocutor on such issues as religious education in schools.

The integration of Islam should be easier in Germany than in fiercely secular France. German law stops short of separating church and state, because the country values religion as a force for good. Yet achieving the conference's goals will be hard. As elsewhere, there is bickering between Islamic groups. Mr Schäuble said afterwards that he expects Muslims to sign up to Germany's “basic social and religious principles”, such as equality of men and women.

The cancellation of the Mozart opera may even speed up the process, because it shows the importance of averting a real clash of cultures. It is a good sign that the conference's participants not only called for the opera to be reinstated but said they wanted to go and see it.

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Charlemagne

In Europe we don't trust

Sep 28th 2006
From The Economist print edition

Lessons from a thumbs-up to new members and a thumbs-down to majority voting in judicial matters

TAMPERE, north of Helsinki, is hardly the hub of Europe. A sort of Finnish Manchester of days gone by, it is dotted with once-derelict cotton mills, their giant chimneys reflected in grey canals. Yet it has twice been the place to decide the fate of one of the European Union's grandest designs. In 1999 ministers decided in principle to put parts of Europe's national criminal-justice and policing systems under the control of common institutions in Brussels. Then last weekend they decided in practice not to do so (at least for the time being).

Since 1999 European governments have done much to link their judicial systems and to recognise each others' legal judgments. Although most people do not yet realise it, a European arrest warrant now allows a judge in one EU country to order the arrest of a suspect in another. Had the Spanish judge, Baltasar Garzon, issued his warrant for the arrest of General Augusto Pinochet today, Britain (which he was visiting) would probably have had to extradite the former Chilean dictator to Spain.

There is also now a European evidence warrant, which allows judges in EU countries to order the seizure of evidence abroad. Austrian judges might have been able to use this earlier this year to require British police to confiscate and hand over documents owned by David Irving, the British historian, when he stood trial for Holocaust denial in Vienna, even though Holocaust denial is not a crime in Britain.

But these steps are not enough for some European governments and the European Commission. They want faster, more efficient legal action against terrorists, drug smugglers and those who commit crimes across borders. They argue that, because national governments control criminal-justice and police systems, it is hard to get all 25 (soon to be 27) countries to co-ordinate legal actions. So they want decisions about criminal justice to be taken by majority vote rather than consensus. This would mean that national parliaments and courts would no longer have sole control over their criminal-justice systems. The commission and the European Parliament would gain some competence not only in serious cross-border crimes but, possibly, in criminal law in general. That is roughly what the commission asked national governments to accept in Tampere last week.

A majority of governments balked. Ireland objected on principle: its justice minister said the idea was an offence against national sovereignty. Germany objected to the tactics, rather than the principle. It said

some of the legal proposals were already in the draft constitution that the German government desperately hopes to resurrect—and that it did not want to initiate a separate ratification process. Britain havered but eventually came down against the plan. Since it takes a unanimous decision to get rid of unanimity, it seems likely that the whole idea will now fall (although, with the commission still committed, it may be postponed rather than dropped altogether).

Criminal justice and policing involve the most fundamental of state powers: the ability to deprive citizens of their liberty. People more or less trust national governments to exercise this power. They are extremely reluctant to place their faith in anybody else. That makes it understandable that so many governments and voters have reservations about transferring any authority in criminal-justice matters to Brussels. But they are the more suspicious because this extension of power is being mooted at a time when distrust within the EU is growing.

This week the commission said that Bulgaria and Romania should join the union from next January. This was always going to happen: the two were promised entry by 2008 in any case. What was striking were the conditions the commission imposed and the sanctions threatened if the countries do not meet certain standards (see article). Manifestly the commission does not have confidence in the new members to deliver.

Distrust and verify

A modest degree of mutual suspicion has existed in the EU from the start: the original members did not fully trust Italy to abide by the rules (they still don't). Later, everyone doubted Britain's commitment (they still do). But by and large the project was a high-trust affair, which was both a cause and a consequence of having only six or, later, 12 members.

Now enlargement to 25 has produced a fresh source of misgiving. Witness the role that the mythic figure of the “Polish plumber” played in the rejection of the European constitution by French voters. Witness, too, the opposition to liberalising Europe's services for fear of being overrun by “unfair competition” from other EU countries. To the old members of the club, the collapse of the Polish and Czech governments, riots in the streets of Budapest and the rise of nasty populists in Slovakia only confirm that the class of 2004 is not trustworthy. Bulgaria and Romania are worse; and the applicants to come, notably Turkey, are beyond the pale. The commission president said this week that there should be a pause in further enlargement.

A desire to win back popular confidence is understandable. But trying to do so by suspending expansion would damage both applicant countries and the EU itself. And insisting on closer integration by abolishing national vetoes over such matters as the criminal law could backfire badly.

Institutions do not always need high levels of confidence to operate. Indeed, America's Founding Fathers designed a successful system of government partly on the presumption of suspicion (“the only maxim of a free government ought to be to trust no man living with power to endanger the public liberty,” said John Adams). The EU should learn to live with some mutual suspicion, by moderating its ambitions and respecting national self-interest, rather than pretending that it can go back to the days when countries trusted one another enough to pool big chunks of their fundamental sovereignty.

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Supermarkets

A long, long way from Bentonville

Sep 28th 2006
From The Economist print edition

Corbis

Why British shoppers are sniffing at everyday low prices

Get article background

EVEN at 10pm, vehicles cluster on the damp tarmac of a car park on the fringe of London's East End. Under a vast roof, children skip through wide supermarket aisles in their pyjamas while young couples wrestle with trolleys laden with mountains of shopping. A battalion of packers stocks the shelves. It looks a picture of rude corporate health.

But look more closely at the feeble selection of fresh vegetables and the paltry few feet of shelving given to organic products (many near their sell-by date); look at how far from the entrance shoppers must walk to find the ready meals that are so loved by London's professionals, and these aisles tell a different story. They help explain why the shoppers thronging this store are younger and poorer than the average and why Asda, a supermarket owned by Wal-Mart, the world's biggest retailer, is struggling in Britain.

Asda's performance is of no small consequence to Wal-Mart, which bought it in 1999 for $10.8 billion (£6.7 billion). The company is by far Wal-Mart's largest business outside America, accounting for about half its international income and roughly a tenth of its overall sales. More important, though, Asda is a litmus test for whether Wal-Mart can export its model of wooing shoppers with little more than keen pricing.

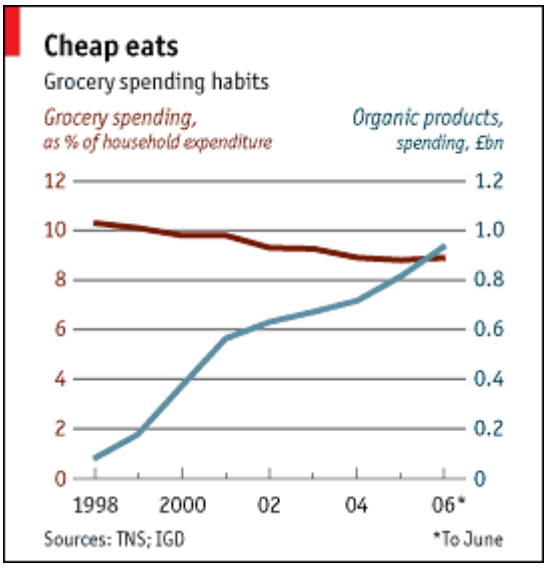
Wal-Mart's other international adventures have met with limited success. This year it pulled out of two countries: South Korea—where it failed to decode the shopping habits of the nation's housewives—and Germany, where it could not beat incumbent discount stores on price.

But Britain was always Wal-Mart's great hope. Here was a country with an established supermarket culture. The natives shopped in similar ways to Americans (who tend to prefer large, one-stop excursions, unlike Germans, for example, who buy their ham from one store, their toilet paper from another). Moreover, in Asda, Wal-Mart found a fellow traveller. The British firm was growing fast by using many of the same strategies that had enabled Wal-Mart to leave behind its humble beginnings in Bentonville, Arkansas.

After Wal-Mart bought it, Asda continued to prosper for a few years. By 2003 it had managed to seize

market share and overtake J. Sainsbury, long the supermarket of Britain's middle classes, to become the country's second-largest retailer behind Tesco, which commands almost a third of the market.

But even as Asda grew, British shopping habits were changing. Low prices, Asda's main appeal, were becoming less important. Whereas four decades ago almost a quarter of household expenditure went on groceries, just 9% does now (see chart). All Britain's supermarkets have relentlessly pushed their suppliers to cut costs; as a result, price differences between chains have narrowed.



A trolley of 100 common items bought at Tesco for £173.97 ($330.26) would cost just 74p less at Asda, according to *The Grocer*, which compiles a weekly price index. Comparing bigger shopping baskets of 10,000 items yields a similar result, with Asda and Tesco charging the same for almost three-quarters of their goods. Such differences as remain are too small to be noticed by most shoppers.

A 2006 study by IGD, a grocery-industry think tank, found that just 42% of shoppers consider cost when choosing which foods to buy, down from 46% in 2003. Yet until recently Asda continued to tout its low prices, running adverts with shoppers tapping their pockets to suggest they are leaving the stores with spare change. (Its current campaign features Coleen McLoughlin, fiancée of Wayne Rooney, a pugilistic footballer and working-class hero.) “They talk more about cheap prices than about quality food,” says Nick Harrison of Mercer Management Consulting. “That just reinforces a perception that the quality may not be as good.”

A second trend missed by Asda was a change in British culinary habits, signalled by the rise of the celebrity chef. More people now cook meals from scratch, eat out and try new foods, helping to boost the popularity of posh cuisine. According to IGD, premium brands, distinguished by the use of words such as “finest” or “select”, which cost more than cheaper “value-branded” cousins, now account for almost 10% of grocery sales.

So too with organic foods. Although they represent just 1.5% of the market, sales are growing rapidly. TNS Worldpanel, a research firm, reckons that sales of organic milk, for instance, have doubled in two years. “Organic has taken off dramatically and we've ignored it until recently,” says Asda's chief executive, Andy Bond. “These trends are affecting everyone, not just the affluent.”

Stores such as Tesco, Sainsbury's and Waitrose (a fast-growing supermarket chain catering for people too refined to shop at Sainsbury's) have gained a double benefit from selling classier brands. Not only do such foods yield juicier margins, but they also attract the customers that retailers most want in their shops: rich people who don't look at prices. Just 2% of Sainsbury's customers say they chose the store because of price, while 31% cite good-quality products.

Tesco and Sainsbury's are now increasing their sales faster than Asda, according to TNS Worldpanel. Following almost ten years' growth, Asda's market share has slipped slightly to 16.7%. It was the only big supermarket to lose ground in the past year other than Morrisons, which botched a takeover in 2003 and has been forced to close stores. Wal-Mart executives have said that the company, which does not disclose its profits separately from its parent's, has missed both profit and sales targets in the past year.

Mr Bond has been cutting prices aggressively, opening separate clothing and home stores and widening Asda's range of premium and organic foods. He is also paying more attention to customers' health concerns by copying rivals who are cutting salt, fat and sugar from ready meals. But none of this will be readily apparent to older and more affluent shoppers who have already departed for rivals' more verdant aisles.

Asda is now in a bind. Stocking its shelves with posh foods its existing customers don't particularly fancy will lead to costly increases in waste. Failing to do so means Asda will never be able to win back the high-spenders it really needs to increase sales. More missed targets and grumbles from the folks back in Bentonville may be in store.

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Green business

Virgin territory

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Richard Branson's move to cut greenhouse-gas emissions

CARBON consumption could hardly be more conspicuous, or extravagant, than jetting out to space for a quick peep at the heavens before coming home in time for tea—a form of tourism being pioneered by Sir Richard Branson, the British entrepreneur behind the Virgin brand. Having helped to invent a new way for the rich to add to the world's abundance of greenhouse gases, Sir Richard is now trying to curb that growth.

Last week he pledged to reinvest profits from his airline and train transport businesses into alternative energy. One such scheme, announced earlier this month, involves building plants in America to make fuel from crops. In all, he plans to devote some $3 billion (£1.6 billion) to green power sources over the next ten years. Then on September 27th he called for the airline industry to cut carbon emissions by as much as a quarter through simple expedients such as towing aircraft to runways and gliding them gently to land.

Why the outbreak of greenery? Sir Richard says that he has belatedly woken up to the dangers of global warming and is concerned the climate is near a “tipping point” where small increases in greenhouse gases can lead to big changes in temperatures. His epiphany is said to have come during a meeting with Al Gore, the former American vice-president turned alarmist film-maker. Cynics point out that his hankering for greener planes and fuels might be aimed at reaping government subsidies for biofuels and heading off further regulation of transport emissions.

Last week Parliament's environment committee said the government needs to do more to deal with the rapidly growing impact of aviation on the climate. Pressure to limit airline emissions is mounting in Britain, mainly because the industry is producing an ever-larger share of the country's greenhouse-gas output. Air traffic already accounts for about 5.5% of the country's CO2 emissions but the effect may be larger than that figure suggests: scientists worry that pollutants released at high altitude are especially potent.

Carbon emissions from airlines rose about 12% in 2004, says Richard Dyer of Friends of the Earth, an environmental campaign group. And passenger journeys are expected to more than double to about 500m a year by 2030.

The industry has resisted attempts at regulation in the past. When the idea of including aviation in the European Emissions Trading Scheme was first mooted, they swiftly mounted a campaign to argue that regulation was unnecessary. Snazzy new technologies and a desire to cut fuel costs would improve efficiency without government intervention, they claimed.

In light of existing pledges by airline bosses to improve the fuel efficiency of new aircraft by 50% over the two decades to 2020, Sir Richard's call for a 25% reduction looks neither ambitious nor particularly original. But his foray into green energy may be more determined, especially when set against commitments by larger firms such as BP and GE. This week Neste Oil, a Finnish energy company, said it would spend “several billion euros” on biofuels, illustrating what a booming industry alternative energy is becoming. And any breakthrough in biofuels would fit well with Sir Richard's existing investments in transport. His ideas might not be ground-breaking, but they could well prove money-making.

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Age-discrimination legislation

Hire the aged

Sep 28th 2006
From The Economist print edition

New laws to regulate Britain's growing army of old workers

SWEEPING age-discrimination laws will take effect on October 1st, with British companies in various states of readiness. The regulations outlaw discrimination against most workers under the age of 65. Those who are kept on beyond that age must be given six months' notice of any attempt to "retire" them, lest it be used as a cover for sacking. The employee may appeal against the employer's decision.

Small firms are nervous. A recent poll of Business Link, which counsels small businesses, revealed that 90% of their advisers reckon small companies are unprepared. Their lack of specialist staff makes it harder for small firms to decipher the new rules, complains Simon Briault of the Federation of Small Businesses. Companies in Britain currently spend £210m ($400m) per year on employment-tribunal claims. That could increase sharply if grey areas within the legislation lead to a deluge of legal challenges.

Some 58% of British 55-64-year-olds currently eschew the pipe and slippers in favour of continued employment. That compares with 44% in France and just 33% in Italy. In the past year, the number of Britons in employment has risen by 220,000. Some 99,000 of these new workers were over retirement age.

Loose labour regulations are one reason. French laws make it hard to dismiss workers. Companies therefore try to recruit for the long haul, which means they seek young blood, says Stan Siebert, a labour economist at Birmingham Business School. And many continental workers are encouraged to leave their jobs. Early-retirement programmes were introduced in an effort to clear space in the labour market for younger workers. In 2003, public expenditure on early retirement accounted for 0.46% of GDP in Belgium and 0.1% in France. No such incentives exist in Britain.

Demographic change is another reason why the workforce is greying. By 2025, 40% of the British population will be over 50. Rising life expectancy and worries about the value of pensions mean the trend to work will continue.

Big companies that rely on casual labour are already adapting. Marks & Spencer, a supermarket, offers schemes such as dependency leave, which entitles carers to four weeks' paid break—useful for older workers with partners in poor health. The over-60s account for 5% of its workforce, 80% of which is part-time.

Since the supermarket check-out rather than the golf course is already the habitat of many in their twilight years, the new age-discrimination laws are unlikely to trigger a radical change in working habits. Yet these broad changes are bound to have a force of their own. As the ranks of grey-haired workers swell, they will become more demanding—laws or no laws.

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Flags

County pride

Sep 28th 2006 | DAWLISH, DEVON
From The Economist print edition

Patriotism in the shires

UNLESS their footballers are engaged overseas, the English are not a flag-waving people. Unlike in America, say, or Norway—both of which have proud flag-flying traditions—native reserve and lingering associations with the far right have tended to keep the Union and St George's flags off the nation's lawns.

But things are changing among the hedgerows and villages of Devon, a county in south-west England. Here the green, white and black flag of St Petroc flutters from windows and rooftops, and even from the flagpole at County Hall, all in cheery defiance of rules that make it illegal to fly most non-national flags without planning permission.

This is not the revival of some ancient symbol. Although the flag's colours have some historical significance (they were flown by the first Viscount Exmouth, a local noble, at the bombardment of Algiers in 1816), the design itself dates back only to 2002, when the idea of a county flag was mooted on a local BBC website. After much debate a dozen designs were short-listed and residents were invited to vote for their favourite.

The winner was chosen in 2003, and since then sales have been breezy. One website offers cufflinks, fridge magnets and window stickers alongside flags, and sightings have been confirmed as far away as Canada and Australia. Local patriots have created a list of flag days that includes July 30th, the anniversary of the 1588 battle against the Spanish Armada (Sir Francis Drake, a local hero, was second in command), and December 8th (in honour of the slightly less well-known St Budoc of Plymouth).

One reason for this outbreak of Devonian patriotism, says Mark Stoyle, a Southampton University historian, is rivalry with Cornwall, a neighbouring county with a rather older flag of its own and a proud tradition of waving it. “Devonians have been thinking, ‘the Cornish have a flag, why shouldn't we have one too?'” And he points out that a strong local brand can attract visitors—handy for an area that depends on tourism for its livelihood.

That combines with rebellion against a uniform national culture (the high street in Exeter, Devon's county town, has the lowest proportion of independent shops in Britain) and resentment at the migration of moneyed Londoners to the country. “As we become more homogenised, people cling to things that set them apart,” says Professor Stoyle.

Flag mania is creeping beyond the south-west. Lincolnshire adopted a democratically chosen flag last October. Derbyshire hoisted its own last week, and there is a campaign for a Dorset flag as well. Michael Faul, editor of *Flagmaster*, a vexillological journal, believes that Scottish and Welsh devolution may be one reason for the trend. Now that two British nations have been encouraged to assert their own identities, lesser patriotisms have been unleashed, too.

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Alcohol

Soho surprise

Sep 28th 2006
From The Economist print edition

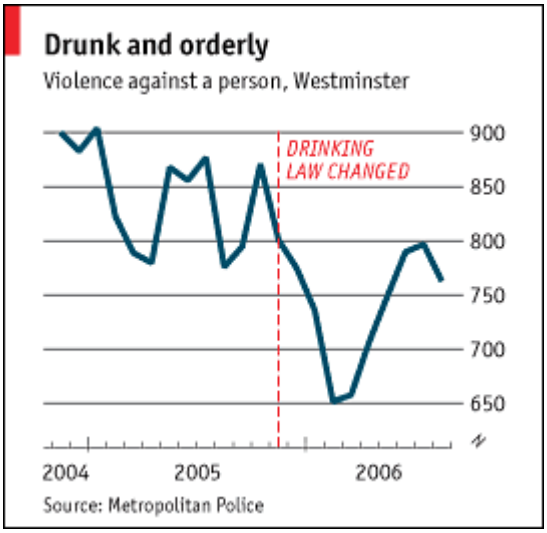
What happened when drinking hours were liberalised

ENGLAND'S binge-drinking habit is one of the most entrenched in Europe—even Roman invaders wrote about it with horror. Many feared that the habit would worsen after the relaxation of licensing hours last November. Doctors, academics and newspapers were joined in opposition by the police and judges, who warned that the reforms were “close to lunacy”. The government disagreed—and abolished a restrictive regime first imposed during the first world war by David Lloyd George, the prime minister, who wanted to prevent munitions workers from getting too drunk.

While ministers never denied that Britons had an unhealthy attitude to liquor, they argued that much of the crime and disorder that blighted city streets at night was caused by hordes of drunkards rolling out of pubs and clubs at the same time and fighting for the same taxi home. They cited the wartime experience in Australia, where an early closing time had led to a phenomenon dubbed the “six o'clock swill”, in which people drank themselves silly against the clock. The hope was that, once hours were relaxed, Britons would adopt more civilised, continental habits, sipping delicately at glasses of Chablis rather than downing ten pints. Were the optimists or the pessimists right?

Since the law was changed, around two-thirds of licensed premises have extended their opening times, most by an hour or so. (Fewer than 1% were granted a 24-hour licence.) That smoothed the 11pm and 2am chuck-out peaks and filled in some of the troughs. And Armageddon did not come to pass.

Local authorities in several large, lively cities, including Birmingham, Nottingham and Manchester, report that the streets are no more disorderly than before. One popular drinkers' street in Birmingham has seen a dramatic drop in crime (although that may also be because businesses, fearing the worst, paid for street wardens). In London, most strikingly, there has not been a single month since the drinking laws were relaxed when more violent crimes were recorded than in the same month a year earlier. That is also true in Westminster (see chart), where many of the capital's pubs and clubs are clustered. Overall levels of violence in the borough have fallen by 12% in the ten months since November 2005, compared with the same period a year before.



The police remain cautious (or perhaps, given their opposition to the reforms, sullen) about such positive signs, saying it is still too early to tell what effect liberalisation will have on crime. They point out that local forces have diverted time and money to police late-night drinking, and have been given extra cash by the government. That will run out on Christmas Eve, at which point things may become trickier.

In the meantime, pessimists are marshalling new, more ambitious arguments. Martin Plant of the University of the West of England maintains that freer drinking can lead to long-term problems that are not immediately apparent. Iceland's capital, Reykjavik, softened drinking laws seven years ago. While policing became easier, more drunkards pitched up at hospital and drink-driving rates soared.

In one way, freer drinking already appears to have increased lawlessness. Despite all those extra officers, muggings in London have risen by 8% since drinking hours were deregulated. And a growing proportion of those muggers—21% last year, according to the British Crime Survey—were drunk at the time. It may be that,

by replacing a flood out of pubs and clubs with a steady dribble, the new drinking hours have reduced fights over taxis. But as group disorder has declined, individual scraps may have risen.

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Private provision in the NHS

Demonstration effect

Sep 28th 2006
From The Economist print edition

The threat of competition is what matters

Get article background

IN ONE respect at least, Labour's obsession at this week's conference with the succession to Tony Blair served the government well. It distracted attention from the groundswell of opposition within Labour ranks to reforms in the health service.

On September 27th, the conference ignored the pleas of Patricia Hewitt, the health secretary, and voted for a motion calling on the government to “rethink the headlong rush to a competitive system”. On the same day, Unison, the public-sector union that had put forward the motion, staged a second one-day strike protesting against the government's decision to outsource the health service's logistics arm to DHL, a German company.

A lost vote at conference and a union walk-out will not change the government's policy. But both served as a painful reminder of the extent to which its market reforms run up against Labour's producer lobby. Health-service staff and unions are especially annoyed about the decision to buy operations from the private sector.

The first wave of these independent treatment centres will provide around 170,000 procedures a year over a five-year period. The NHS is currently procuring a second wave, which will add a further 250,000 annual treatments. Together, they should provide 7-8% of non-emergency procedures in NHS hospitals by 2008.

If the new treatment centres hit a raw nerve for many Labour members, the charge that they represent poor value for money is just as painful for ministers. A recent investigation by the *Health Service Journal* suggested that their performance until April 2006 was disappointing. The magazine worked out that the new private centres had done only 59% of the average annual number of operations they are expected to carry out. Such a shortfall would cost the NHS dear since it has agreed to pay £350m a year for the first wave of treatment centres.

However, these estimates are likely to make Ms Hewitt cross rather than embarrassed or repentant. Her department contests the journal's approach on two grounds. First, it is incorrect to assume that the volume of work is evenly distributed over the five years of the contract. Several of the contracts allow for a build-up in work. Second, the contracts are based on value and in many cases the local commissioning trusts have been able to switch work to fewer but more costly operations.

The department's own figures show that by July around 80% of the value of operations contracted for in the independent sector had been carried out. That's a much healthier-sounding figure for Ms Hewitt. Furthermore, it is likely to improve further as the treatment centres get into full swing. So far only two-thirds of those planned in the first wave have opened. By July they had carried out 75,150 elective procedures—less than a tenth of the total planned over the full five years. Inevitably, it takes time for doctors and patients to start using the new facilities. The utilisation rate should rise over the lifetime of the contracts.

The dispute over the performance of the treatment centres is premature. It also misses their most important purpose: to break the monopoly of provision within the NHS. That is why so many health-service staff dislike them. And that is why they are so vital if the whole of the NHS is to deliver better value for money.

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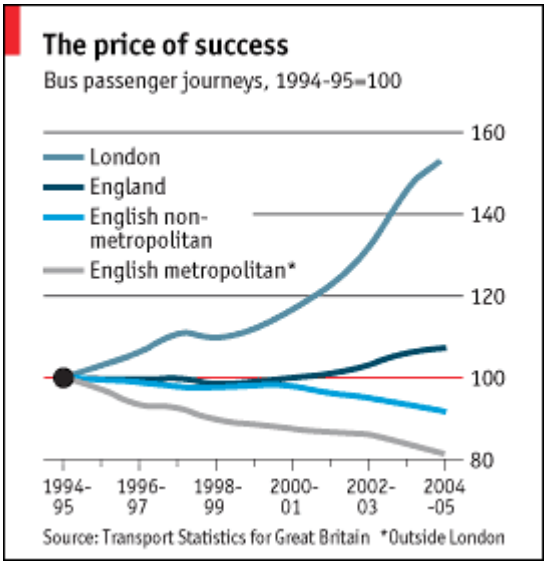
Buses

The wheels on the bus

Sep 28th 2006
From The Economist print edition

London points the way to popularising buses—local control and big subsidies



"A MAN who, beyond the age of 26, finds himself on a bus can count himself a failure." So Margaret Thatcher is reputed to have said in 1986, the year her government privatised and deregulated Britain's bus networks. Officially, at least, the Labour government disagrees with such sentiments: in 2000, it pledged to increase passenger numbers across Britain's bus networks by 12% by 2010.

A report published this week by the Passenger Transport Executive Group, an association of local transport officials, reveals the scale of the government's failure. Overall passenger numbers are up slightly, but that modest good news masks big falls both in the shires and the cities, where numbers have fallen by a tenth and a fifth over the past decade (see chart). Only in London have numbers risen, by over 50%. The capital's network carries 6m people every week on 700 different routes. That, says Transport for London (TfL), which runs the system, makes it one of the world's biggest.

Part of this success is down to the fact that London is a big, congested city. Gridlock on the capital's roads makes car travel unattractive. The Tube is one alternative, but many lines are stuffed to capacity. Relief will not come for several years, and there are large bits of the city that the network does not serve. For many commuters, buses are the only alternative.

But congestion is common in other cities, too. A more important reason for London's exceptionalism is that, unlike in the rest of the country, services in the capital were never deregulated. That means TfL can specify every detail of a particular route—length, frequency, fares and even the colour of the buses. Private firms then bid to run these routes, many of which are only profitable thanks to public subsidy.

Outside London, companies can set up and run any routes they like. Local authorities can fill gaps in the private networks, but only if they decide, on rather nebulous social grounds, that the service is inadequate. That causes problems, says John Dodgson, the report's author. In pursuit of more passengers, private firms may refuse to offer tickets that work on other forms of transport, or to co-ordinate their services with, say, the railways.

In the capital, by contrast, Ken Livingstone has great power over transport. His flagship congestion-charging scheme, introduced in 2003, makes driving in London's crowded centre even less attractive. It prods drivers onto buses and makes space for them on the roads. Mr Livingstone has made expanding London's bus network a priority, and has backed that pledge with taxpayers' cash. London's buses received £783m of public money in 2004-05, almost a threefold increase since 2000-01. Passenger numbers during that period have surged. Fares in London are roughly the same in real terms as ten years ago: in other big cities they have risen by an average of 86%, while the cost of motoring has hardly changed.

All that suggests that if the government is serious about getting more people onto buses, it needs to give local authorities control over routes, and to fund them generously. On the first point, Tony Travers, a transport expert at the London School of Economics, is cautiously optimistic. Two big reviews due later this year—one into transport, the other into local government finance—may point in that direction, he

believes. The funding question is tougher. Ministers are already embarrassed about the vast amounts of public money consumed by the newly popular railways. A similarly big cheque for the bus industry would be a hard sell.

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Bagehot

They'll miss him

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Tony Blair's farewell to his party was a reminder of what it is losing

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"WE DON'T want to lose you, but we think you ought to go." The words on the famous first world war recruiting poster sum up the tangle of emotions that gripped the Labour conference in Manchester after Tony Blair's beautifully judged farewell speech to his party. Labour is apprehensive of the future without Mr Blair and well aware that his likely successor has neither a fraction of his star quality nor the perfect pitch of his appeal to the crucial voters of middle England. But they also applauded when the prime minister said that although letting go was hard, it was right "for the country, and for you, the party".

There were many in the G-Mex hall who found themselves wondering why they were getting rid of their party's most prolific election-winner while he was clearly still at the height of his powers. But if Mr Blair had not been heading gracefully for the exit, the mood would have been very different.

For most of his party, the damage done to Mr Blair's popularity by the war in Iraq and his closeness to a widely loathed American president are the indelible stain on his otherwise successful premiership. A passage in Mr Blair's speech that put Iraq in the context of what he called "the global struggle against terrorism without mercy or limit" was heard in near-silence. Anger over his refusal to call for an immediate ceasefire in Lebanon was one of the triggers for the clumsy attempted coup against him three weeks ago.

Not that Mr Blair was apologetic. He described how, during his decade in Downing Street, the challenges facing government had shifted from the essentially domestic—managing the economy, rebuilding neglected public services and fighting poverty—to more threatening and intractable global concerns. Those include not just terrorism but mass immigration, looming energy shortages and climate change.

Above all, he wanted to remind his party how it had won three successive elections and could win a fourth: by an unceasing focus on people's hopes and fears. "The core vote of this party today", he said, "is not the heartlands, the inner city, not any sectional interest or lobby. Our core vote is the country." New Labour, he boasted, had created a coalition by reconciling compassion with aspiration. Now the task was to reconcile liberty with security. The only legacy that had ever mattered to him, insisted Mr Blair,

was winning a fourth election victory.

If Mr Blair thinks he knows how Labour can win a fourth term, he is a good deal less certain about who is capable of delivering it. In a concerted effort to patch things up following the recent unrest, Mr Blair and Gordon Brown each paid public tribute to the other this week, while acknowledging how fraught their relationship has often been. According to Mr Blair, Gordon was a remarkable man without whom those three election victories could not have been won. Left unsaid was whether, on his own, Mr Brown could win a fourth. The chancellor was more lavish in his praise, perhaps too much so.

The unintended news story of the conference was Cherie Blair's outburst while watching Mr Brown's speech on a monitor outside the hall. When the chancellor claimed that working for Mr Blair had been “a privilege”, Mrs Blair reportedly exclaimed, “Well, that's a lie.” She later denied having made the remark. But with the best joke of the conference, Mr Blair made no pretence about her feelings towards the chancellor, saying that at least he didn't have to worry about his wife running off with the bloke next door.

For Mr Brown, Mrs Blair's indiscretion was no laughing matter. His own speech had at times sounded like a rambling job application, but it was one of his better efforts. Bludgeoning his audience less than usual, Mr Brown spoke about what motivated him in politics: the unswerving moral compass bequeathed him by his parents. And without departing from New Labour orthodoxy, he gave some clues about how his leadership would differ in style from Mr Blair's. Received with respect rather than rapture, he avoided the fate of David Davis, the Tory leadership front-runner whose campaign unravelled after a dire conference speech last year.

Damaged goods

But with that single word, “lie”, Mrs Blair drew attention to some of the doubts about Mr Brown. For all his moral passion and intellectual strength, the belief that the chancellor is a flawed character has taken hold. His attempts to repair the damage caused by being associated with the plot to drive Mr Blair prematurely from Downing Street have met with little success. Frank Luntz, an American pollster, whose focus group polling for the BBC's Newsnight programme helped persuade Tory activists to see David Cameron as their best electoral hope, this week came up with damning findings against Mr Brown.

Thirty voters, two-thirds of them Labour loyalists or Labour-leaners, the rest floaters, were presented with biographies, speeches and interviews of five potential candidates for the Labour leadership, including Mr Brown. Worryingly for Mr Brown, they found him stale and too Scottish. Much worse was the reaction to an interview Mr Brown gave the weekend after the attempted coup. When he denied involvement, not one person in the focus group believed him. Mr Luntz described it as the worst-received interview he had ever tested in Britain. Outside the conference hall, the Newsnight programme was playing over and over again to large audiences.

Although Newsnight's focus group preferred John Reid, the home secretary, to Mr Brown (there is reason to believe that secretly Mr Blair does too), it remains overwhelmingly likely that the chancellor will be Britain's next prime minister. If he is, it is equally likely that the Labour Party will miss Mr Blair more than anyone believed possible a few weeks ago.

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Yahoo!

Terry Semel's long pause

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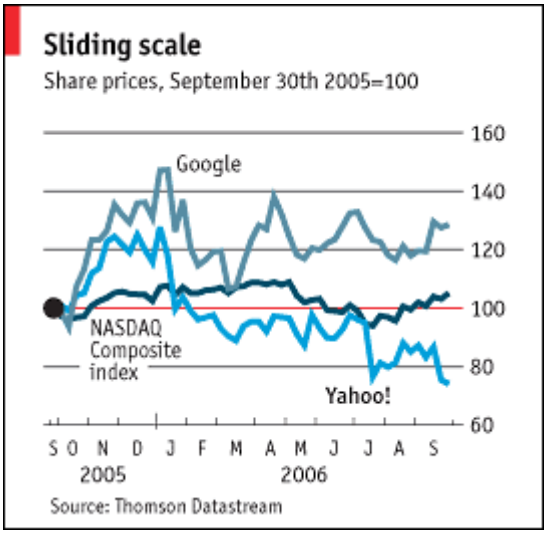
While Google and small internet firms race ahead, Yahoo! seems to be standing still

AP

“NOW let's just pause for a second.” It is the fourth pause for thought that Terry Semel, chairman and chief executive of Yahoo!, has requested in about ten minutes. He is trying to marshal various arguments to prove that his firm, the world's largest internet company by visitors to its website, has a coherent and winning strategy compared with Google, a phenomenally successful search engine. With only slightly bigger revenues, Google has three and a half times the market value of Yahoo!. Twice in three months Wall Street has dumped the shares of Yahoo! and widened the gap (see chart).

The first sell-off, in July, came after Mr Semel announced that Panama, an ambitious project to improve Yahoo!'s technology so that it can make more money on each of its users' searches, would be delayed until the end of this year. Yes, agrees Mr Semel, it was supposed to be released a quarter earlier, but this sort of market reaction was silly. Unlike Google, which has a habit of releasing sloppy brainstorms in test versions called “beta”, he says, Yahoo! wants to launch a fully functional product, and therefore had to be cautious—and since the financial benefits will come next year, why should the stockmarket get into such a tizzy?



The second sell-off happened last week, when Mr Semel warned investors at a conference hosted by Goldman Sachs that growth in online advertising was not quite what he had hoped. Quarterly earnings would be on the low side of his previous estimates. In particular, Mr Semel noted slower growth in demand from carmakers and banks—Yahoo!'s biggest customers—for graphical advertisements, the category in which it outsells all its rivals. “Let's pause for a second,” he says again. “We still expect to outgrow the segment in 2006. This is not about a tragedy or disaster; it's just pointing out something that we had seen.”

Part of the problem for Yahoo!, however, is that nobody else appears to be seeing a slowdown. This week

the Interactive Advertising Bureau and PricewaterhouseCoopers, a consultancy, jointly released the latest industry numbers, which show that online advertising in America grew by 37% to $7.9 billion, a new record, in the first half of the year. Another firm that tracks online advertising, eMarketer, cut its forecasts, but that was in response to Mr Semel's statement. Jim Lanzone, the boss of Ask.com, the fourth-largest search engine after Google, Yahoo! and Microsoft's MSN, says that his firm is not seeing any similar easing of demand.

The deeper problem, says Henry Blodget, founder of Cherry Hill Research, a consultancy, is that Yahoo! is still suffering from a “colossal error” it made in the late 1990s. At that time, it already wanted to become a portal, or a gateway to content on the web, but thought that search would be at most a feature, not a business in its own right. This allowed Google to dominate the category. “By the time Yahoo! realised its mistake about three years ago it was too late,” says Mr Blodget. Google's share of search queries has been growing, and the enormous profits from this product allow Google to invest more than Yahoo! does.

Mr Semel counters that Google's gains in search have not come at the expense of Yahoo!, which has been a steady number two. MSN has been the primary loser. Panama will help. And there are differences between Yahoo! and Google which favour his company. For advertisers, the difference is supposed to be that Yahoo! is more of an all-round online media company, selling the full gamut of advertising, from pay-per-click text snippets on search pages to interactive banners, whereas Google sells almost exclusively pay-per-click advertisements. As such, Yahoo! benefits from its huge leads in web-mail and finance and general news, where Google is a tiny, niche competitor.

For consumers, the difference is supposed to be that Yahoo! is about human beings, whereas Google is about soulless machines and algorithms. So Yahoo! has bought several young firms such as Flickr, a photo-sharing site, and Del.icio.us, a bookmark-sharing site, which both allow users to “tag” the pictures and web pages they encounter, and pass them on to each other. There is Yahoo! Answers, where users can ask real questions and other users respond. Yahoo! started the service nine months ago, and it now has more than 50m users in 20 countries. Yahoo! has fared less well with its social-networking site, Yahoo! 360, and is now negotiating to buy Facebook, a networking site used by many American college students.

But none of these is a solid answer to Yahoo!'s woes. The “tagging” that Flickr and Del.icio.us offer is still far from the mainstream, and are mostly used by hard-core technology geeks. Yahoo! Answers is growing, but arguably full of rubbish. “What is the sexiest food?” is a typical recent question. Answers range from “bacon, mmmmm” to “a pickle” and “anything with a beautiful woman sitting across from it.”

And Yahoo!'s efforts to buy Facebook may illustrate the older firm's shortcomings as much as its market power. Yahoo! was originally interested in MySpace, the biggest social network, but lost it to News Corporation, a media conglomerate. It also wanted to buy AOL, a web portal owned by Time Warner, another media company, but Google swooped in. Yahoo! again lost to Google when the latter won a deal to supply the advertising on MySpace, and then to Microsoft when it struck a deal to deliver advertising on Facebook. Now Yahoo! looks rather desperate, and will have to pay an enormous price for Facebook, a fast-growing company which many big firms have considered buying.

“Days go by and deals go away,” says an outside adviser to Yahoo! who has sat in on executive meetings. The firm has a “relatively constipated process of reviewing anything,” he says. It is slow and cumbersome and “not an entrepreneurial culture” because Mr Semel is a “low-risk, non-confrontational guy”, says this adviser. He recalls a meeting at which an engineer asked: how long do we take from idea to execution? Several people scrawled on the whiteboard and agreed on an answer of eight months.

None of this means that Yahoo! is in dire trouble. If it turns out to be true that online advertising is growing more slowly as a whole, Google and all other internet firms will feel it sooner or later. Christopher Sherman, executive editor of SearchEngineWatch, an online newsletter, says he doesn't think that Yahoo! has lost its way. But “we're past the days of radical innovation where somebody is really going to blow past a competitor.” Yahoo! will have to content itself with a position as the internet's number two, at best.

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Hewlett-Packard

East versus west

Sep 28th 2006 | NEW YORK
From The Economist print edition

In Silicon Valley, HP's crisis rumbles on

THE former chief executive of Hewlett-Packard, Carly Fiorina, is about to publish her autobiography. She is expected to try to defend her role as boss of the computer and printer-maker, and argue that she was ousted just before her strategy started to bear fruit—allowing her successor, Mark Hurd, to grab all the credit. Silicon Valley types are mad as hell at the prospect of her charming gullible east-coast journalists, who, they say, wouldn't recognise an entrepreneurial high-technology culture if it poked them in the eye.

Recent events at HP have made Ms Fiorina's mission easier, especially now that Mr Hurd himself has been tainted by a scandal over the use of unethical and possibly illegal snooping techniques to discover which member of the firm's board was leaking to the press. At first, it seemed that the company's chairman, Patricia Dunn, would carry the can alone for the use by a security firm working for HP of "pretexting": using false pretences to obtain personal information.

Initially, Ms Dunn agreed to step down as chairman in January 2007, but would remain on the board, while Mr Hurd—who has been widely praised for reviving the formerly ailing firm—gained more power, becoming chairman as well as chief executive. But then events started to move against him. It turned out that he had approved sending an e-mail containing false information as part of HP's investigation. He had also been given a report in March on the investigation, but, as he said at a press conference, "I did not read it. I could have, and I should have." This prompted him to apologise for HP's invasion of the privacy of directors and journalists, and Ms Dunn to resign at once—from the board as well as from the chairmanship.

Whether this will be enough to save Mr Hurd remains to be seen. Nobody who cares about the effective management of HP wants him to go. His fate will depend on the results of an independent inquiry he commissioned himself by Morgan Lewis, a law firm. He will also need to pull off convincing public appearances at his testimony (along with Ms Dunn) to the House of Representatives' Energy and Commerce Committee on September 28th, which was due to begin just as *The Economist* went to press.

Although HP's lurid revelations about spying have grabbed most attention, what lies behind the affair is a battle about how companies should be governed. HP's board has fought about this for years. To the old guard on the board, which included Silicon Valley legends such as Tom Perkins, a venture capitalist, the corporate-governance reforms introduced by Ms Fiorina and Ms Dunn threatened to stifle the firm's entrepreneurial culture. These views were aired this week in an article in the *Wall Street Journal* by Viet Dinh, lawyer to Mr Perkins (who quit the HP board in May in protest at the use of pretexting). Ms Dunn is reportedly a "governance perfectionist", wrote Mr Dinh. She could have handled the leaks through a direct, personal conversation with the directors, but instead chose to treat the matter as "part of the board's progression from one that was more personality-driven to one that is process-driven and capable of upholding today's highest governance standards." In this case, of course, her process went horribly wrong.

Much of corporate America worries that the crackdown on governance of recent years will create boards full of the great and the good but with little feel for risk-taking or for what makes a company grow. Nowhere is this more feared than on the west coast. Silicon Valley's resistance to improved corporate governance is also reflected in the slapdash attitude to accounting for share options that has resulted in the recent backdating scandal, which mostly involves west-coast firms. On quitting, Mr Perkins wrote to Mr Hurd to wish him well, and to air his fears that Ms Dunn would create a board full of people from big companies "with no fast-cycle technology background, and certainly no Valley entrepreneurial genes".

What happens next at HP—whether, for instance, Mr Hurd manages to keep his dual role as chief

executive and chairman, which governance experts regard as a retrograde step—will be an important test of whether the recent efforts to improve America's corporate governance, cooked up on the east coast, can ever take hold in the wild west.

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European pharmaceuticals

Growth pills

Sep 28th 2006 | PARIS
From The Economist print edition

A spurt of mergers is uniting Europe's smaller drugs firms

THERE are two kinds of mergers in the pharmaceuticals industry, says Roch Doliveux, boss of UCB, a Belgian drugs company. One is an act of desperation by two firms hoping that getting bigger will solve all their troubles. The other is a union of firms in good shape that want to grow. As you may have expected, he places UCB's takeover of Germany's Schwarz Pharma, announced on September 25th, in the second category. Recent examples of the distressed form, he maintains, are the purchase of Switzerland's Serono by Germany's Merck and the sale of the drugs business of Altana, another German firm, to Denmark's Nycomed.

At first sight, Schwarz, Serono and Altana are similar: of medium size and family-controlled. Schwarz was in the hands of the family of Rolf Schwarz-Schütte, its founder; Serono was run by the Bertarelli clan for three generations; and Altana's controlling shareholder was Susanne Klatten, a member of the Quandt family, one of Germany's richest industrial dynasties. All three were under pressure to sell because of the rising cost of marketing and research and development (R&D), stiffer competition from makers of generic drugs and the efforts of European governments to lower their health-care costs by cutting expenditure on drugs.

Neither Ernesto Bertarelli, the boss of Serono, nor Ms Klatten could find buyers for months after putting their firms up for sale. It was not just the prices they demanded, but also their weak pipelines—industry jargon for drugs in development. Serono has nothing on the way as promising as Rebif, its flagship drug to treat multiple sclerosis. Altana's most successful product is Pantoprazole, an antacid, but it will face competition from generics from 2009. Serono was sold for €10.6 billion ($13.5 billion), a good deal less than its initial price tag. Altana's €4.5 billion takeover also fell short of expectations.

However, Patrick Schwarz-Schütte, the boss of Schwarz and the founder's son, quickly came to an agreement with UCB. He sold for €4.4 billion, a healthy price, without inviting other bidders. Schwarz is about to launch Lacosamide, a treatment for epilepsy, which will come in handy when Keppra, UCB's successful epilepsy drug, comes off its patent. Schwarz's Neupro, a patch to treat Parkinson's disease, has been launched in Europe and was recently approved for use in America. “What matters is innovation,” says Mr Doliveux.

UCB itself is a middle-sized company, controlled by the heirs of Emmanuel Janssen, who founded the firm in 1928. Both companies concentrate mostly on treating diseases of the nervous system. UCB has a distribution network to help Schwarz push its new products, especially in America. The firms will have a combined R&D budget of €770m a year. Neither wants to be swallowed by an industry giant, such as America's Pfizer or Switzerland's Novartis.

In a sign of confidence in UCB's management, the Schwarz-Schüttes will keep a 40% stake in the new company. Patrick Schwarz-Schütte will join the UCB board. Most analysts like the deal, although some worry about future profits. Schwarz relies for almost one-fifth of its sales, and a greater proportion of its profits, on Omeprazole, an anti-ulcer drug, which in 2009 loses its already limited patent protection. For the time being the company enjoys payments for a licence for Fesoterodine, an incontinence drug, from Pfizer. However, these will stop in 2008.

Yet size does help in marketing and distribution, and the new UCB will remain smaller than the industry's giants. Size can also benefit R&D. Firms with big budgets and better laboratories are said to attract more talented researchers. However, others argue that corporate titans can kill the entrepreneurial spirit and flexibility that fosters great discoveries. GlaxoSmithKline, a British drugs giant, has created smaller research units to recreate a more intimate environment, and has seen its pipeline improve as a result.

Nevertheless, more mergers among Europe's smaller drugs firms are widely expected. Analysts predict that Britain's Shire, France's Ipsen, Lundbeck in Denmark and Orion in Finland could all be taken over in the near future. There is a dearth of strong pipelines, says Alastair Flanagan, of the Boston Consulting Group. The urge to get bigger means that there are probably more deals ahead.

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Railways

Still aloft, just

Sep 28th 2006 | FRANKFURT
From The Economist print edition

Maglev trains lose some of their magic

SCHOOLBOY dreams of everyday travel by magnetic levitation (maglev) have been shaken but not destroyed after an accident on a test track at Lathen, Germany. On September 22nd a maglev train ploughed into a maintenance vehicle at 200kph (125mph), killing 23 passengers.

Magnetic attraction and repulsion allow maglev trains to travel along guideways at speeds of up to 500kph. Transrapid, a consortium of Siemens and ThyssenKrupp, has been testing maglev trains at Lathen since the mid-1980s. Central Japan Railway (JR Central) has another test track west of Tokyo, which uses more cumbersome technology, relying on super-cooling. This week JR Central said it would spend ¥355 billion ($3 billion) on lengthening and renewing the track, part of it underground, to experiment with longer and faster trains. In both cases the technology is expensive, so that maglev trains need public backing. Only one, which runs the 30km between Shanghai and Pudong Airport in China, is operating commercially. It was built by Transrapid and helped along by a large subsidy from the German government.

Other projects are in the pipeline, but none has got beyond a feasibility study. China plans to extend the Shanghai line for another 160km to the city of Hangzhou. But Transrapid has not yet secured the contract, which may depend on an agreement to share the technology.

In Germany, Transrapid and Deutsche Bahn would like to build a 37km link between Munich's airport and the central railway station, cutting the average journey time from 40 minutes to ten. The federal and Bavarian governments are in favour, but the local mayor is not: he prefers a conventional railway which would serve non-airport traffic too. Even if he loses the argument, there is no guarantee the government will find the money for the Transrapid line—whose role would be partly to show off the system to potential buyers.

Longer-distance projects in Germany were considered and then rejected, mainly because the country is well served by high-speed trains between big cities. Hamburg to Berlin, which might have been the exception, does not have enough demand from passengers.

It may be that maglev trains stand a better chance in countries where existing railways are less efficient, such as America and Britain. But finding public money is a problem for even the most serious schemes: the California Regional Maglev Project, the Baltimore-Washington Maglev Project and the Pennsylvania High-Speed Maglev Project. Another American scheme, which may belong more in the realm of science fiction, is SkyTran, proposed by UniModal, of Montana. It involves two-seater maglev bubbles scuttling around a three-dimensional urban network or between cities at up to 240kph.

In Britain, UK Ultraspeed, backed by Transrapid, argues that high-speed links, for example across the Pennines, would transform investment patterns. If pairs of cities, such as Leeds and Manchester or Glasgow and Edinburgh, were linked by 15-minute journeys, they could become single economic areas. Although this may be pie in the sky, politicians are beginning to like the sound of it. Last week, local governments in north-east England pledged to examine UK Ultraspeed's proposals.

Over longer distances maglev trains face competition with airlines. But Alan James, project leader at UK Ultraspeed, argues that three hours in a train is more convenient than a one-hour plane trip. A study by America's Federal Railroad Administration presented to Congress last year talks of a “sweet spot”, a range of inter-city journeys of 240-800km, for which maglevs could provide the optimal link. With air travel threatened by emission taxes and heavier security, maglev trains may begin to look attractive over greater distances.

Alternatively, of course, they could remain a white elephant. The crash has prompted a closer look at safety, even though the cause was probably human error. In theory, because of the way they are powered, maglev trains can never collide. Whatever the outcome, schoolboys will continue to dream of trains that never touch the ground.

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Japanese entrepreneurialism

Flying high

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A tale of balloons and small business

Wandering as a cloud

IT IS 2008, and an enormous, gloriously hued dragon balloon, symbolising China's tradition and virility, winds around the Olympic Stadium in Beijing. As it nears, it breathes fire to light the Olympic torch. For the moment, this is just an idea in the head of Naoki Nishi, boss of Show Corporation (in Japanese, *Fusen Kobo*, or balloon factory), based in Hiroshima, but there is every chance of its becoming reality.

Mr Nishi does not fit the stereotype of a Japanese businessman. He used to work in the trade division of a Mazda Motor subcontractor. When his company foundered in the early 1990s, he was appointed head of restructuring. To his company's amazement, he decided to fire himself to cut costs. With many people in similar straits, jobs were hard to find, but by some quirk he had acquired a hot-air balloon licence while at his previous company. He cashed in his pension and insurance for capital and established a start-up in 1993. His initial hot-air balloon strategy failed, however. Then flyaway balloons caught his eye.

Show Corporation now has 16 employees in Japan and 71 in China, where it has based production, and it has cornered the market for large, inflatable character balloons in Japan. At the closing ceremony of the 2002 World Cup in Yokohama, Mr Nishi inflated a balloon 20 metres high in the shape of Mount Fuji in one minute using 25 fans, having beaten more than 250 rival companies for the contract. Show also rents vehicles made out of balloons to Disney World in Florida. They are popular with grandparents accompanying children.

The firm's biggest source of profit now is an environmentally friendly design of balloon. Traditional flyaway rubber balloons were under attack from environmentalists and quickly losing their popularity. Show invented a new type from Japan's traditional, delicate mulberry-bark paper. The firm's reputation was made with events such as the 1998 Winter Olympics, which took place in Nagano, when its dove-shaped balloons were released to prevent live birds being singed by the Olympic flame. Recently (to purists' dismay), Show switched to cheaper rubber balloons that dissolve after exposure to ultra-violet rays. It sells about 200,000 to 500,000 of these every month in Japan, and is expanding its market overseas, from Britain to Dubai.

Now Mr Nishi is inundated with requests for balloons that can be used in industry. The company has

developed an inflatable cushion to break the falls of workers who clean high ceilings. Having found that most deaths in the tsunami that hit Indonesia in 2004 were caused by bodies being hurled against hard things, rather than drowning, Mr Nishi also makes inflatable life jackets that protect the vertebrae from up to 200kg (440lb) of weight. Show's success has brought more private investors, a change from the early days, when 50 banks turned it down for a loan. Mr Nishi continues to build his fortune on air.

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Russian reality television

From sex to Stalin

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The growth and quirks of reality TV in Russia

Your dacha or mine?

ELENA and Danil are living the new Russian dream: they are renovating a house near Moscow, now appointed with a home cinema and photographs of Archibald, their cat. Except they are doing it in the company of the production crew of “Bare Walls”, a reality-television programme that premiered this week. “It's the biggest event in our lives,” says Danil, in answer to the question: why?

Reality TV arrived in Russia only in 2001, in the shape of the wildly popular “Behind the Glass”. The programme's lustful participants became almost as famous as Vladimir Putin, says Grigory Lubomirov, the show's mischievous creator. Its grittiness was especially arresting in a country where television had been long dominated by Soviet propaganda. As reality TV's appeal has started to wane elsewhere, the genre is booming in Russia.

Its chief exponent is TNT, a channel that has bought dozens of western programme formats (including “Bare Walls”, which was adapted from “The Block”), and aims to air a new one every fortnight. Its longest-running show is “House-2”, whose participants are supposed to fall in love while building a house. The original “House” featured married couples; but, explains Roman Petrenko, boss of TNT, married people don't talk enough. Even “House-2”, he says disappointedly, proves that new couples stop kissing after a few months. Still, TNT's revenue has risen ten-fold in four years, without most of the interactive paraphernalia that boosts revenues from reality TV in the west. The firm stands fifth in Russia's overall ratings, with a young and hence more profitable audience. Total television advertising revenue has more than doubled in three years, says Natasha Zagvozdina, of Renaissance Capital, a

Moscow bank.

James Braham, of Southern Star, an Anglo-Australian firm that distributes the format behind “Bare Walls”, says Russian channels no longer buy and dub anywhere near as many foreign dramas as they once did, preferring to Russify scripts or make their own. So reality has become an important element in western media firms' sales to Russia. Surprisingly for a country with a generally low regard for intellectual property, format theft is uncommon. Format-owners are of course keen to ensure that their ideas don't flop or change beyond recognition in Russia.

There have been plenty of idiosyncrasies. Alexander Gromov, producer of “Bare Walls”, says Russians prefer longer narratives: reading “War and Peace”, say, or watching South American soap operas. Russian screen bust-ups, he reckons, are even more spectacular than western ones. Dan Berbridge, a British producer imported by TNT to help oversee its output, says Russian viewers still need convincing that reality participants aren't actors. The Russian version of “Wife Swap”, he jokes, should be called “Babushka Swap”, so prominent are the mothers-in-law. In a culture which is hostile to homosexuality, TNT is mulling how queer to make its version of “Queer Eye for the Straight Guy”.

Russian producers are also reworking the reality genre themselves and, says Mr Lubomirov, will soon export their own formats. His most recent show was “Rublyovko.live”, which mixed real life on Russia's most opulent street (in Moscow) with acting. Russian viewers are bored of sex in reality TV, he claims. His next project is “Stalin.live”, a reconstruction of the dictator's last month: all part of a continuum, he insists, with “Behind the Glass”.

Despite the impression of media freedom created by all the on-air canoodling and Russia's Springer-esque talk shows, there is one kind of reality that is not available on Russian TV: trustworthy, independent political news. All the main networks are controlled, one way or another, by the Kremlin. TNT is owned by Gazprom, a giant state-controlled gas company. Gazprom doesn't interfere with programming choices, says Mr Petrenko—but then TNT concentrates on mere “reality”.

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Photography

Leica refocuses

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The legendary camera-maker belatedly embraces digital technology

PETER MAGUBANE, an acclaimed South African photographer, used to hide his Leica camera inside a hollow loaf of bread to evade the police as he quietly snapped scenes of apartheid. Henri Cartier-Bresson used a Leica to capture his decisive moments; many of the 20th century's defining images were the products of the German firm's cameras. But Leica continued to trade on its illustrious history, and sales slumped as photography moved into the digital age. The firm nearly collapsed last year. With the launch of a digital version of its rangefinder camera, the M8, at a trade show in Cologne this week, Leica hopes to make a comeback.

Although Leica has sold compact digital cameras since 1998, Leica fanatics have been waiting for a digital version of its M-series rangefinders. Unlike a single-lens reflex camera, where the photographer looks through the lens while composing and focusing, a rangefinder camera uses a separate viewfinder with a "split-image" focusing system. This makes it smaller and quieter, and explains Leica's popularity among photojournalists. The new M8 combines classic Leica craftsmanship with modern digital trimmings, such as a 10.3-megapixel sensor.

But can the new camera revive this luxury brand? Most Leicas are sold to art photographers, rich hobbyists and collectors. The M8, which will go on sale in November, will cost $4,795—without a lens. Leica makes other cameras too, such as its R-series single-lens reflex cameras. But, says Ralph Nebe, Leica's marketing director, "the most important impact on us was the loss in sales of the rangefinder camera." As a result, he says, launching a digital rangefinder is crucial.

Leica is hoping that late is better than never. The firm has lost €30m ($38m) since 2004, and has been through a series of restructurings since 1997, the most recent of which was last year. Sales have since picked up, growing by 16% in the year to April, but not everyone is convinced that the company has turned the corner. Just this month Hermès, a French luxury-goods firm, sold its 31.5% stake in Leica to ACM Projektentwicklung, an Austrian investment firm that already owned 36%.

And despite the launch of the M8, photography's switch from film to digital technology could spell trouble for Leica. It is now so easy to tinker with digital images after the shutter has snapped that photography has become as dependent on computers as on cameras. "The newer generation coming up are less enamoured by high-end camera manufacturers," says Steve Hoffenberg, an analyst at Lyra Research in Massachusetts. Leica, however, caters to a unique audience willing to pay for quality and cachet. Richard Caplan, a specialist Leica shop in London, had 25 orders for the M8 before it was even announced.

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Face value

Head barista

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Andrea Illy of Illycaffe is bringing beautiful coffee to the masses

Get article background

IF THERE were only Armani, there wouldn't be an Italian fashion industry—just Armani. But because there are competing Italian fashion brands, there is a whole industry, and Armani itself is bigger. So says Andrea Illy, who looks every inch an Italian fashion executive, but is in fact the boss of the family coffee firm his grandfather founded in Trieste in 1933. His Armani analogy is by way of praising the Starbucks coffee chain—an act that many of his fellow Italians would surely regard as treason.

“Starbucks has done an excellent job of raising consumer interest in coffee, especially in premium coffees,” says the 42-year-old Mr Illy of his rival. Today's booming market for gourmet coffee is the product of vigorous “co-opetition” between various kinds of firm—Starbucks and similar retail chains, big conglomerates such as Nestlé, and upmarket coffee brands such as Illy. “Eight years ago, people talked of coffee as a commodity; now, nobody does,” he says.

Illycaffe had revenues of €227m ($282m) in 2005, and is dwarfed by Starbucks, a public company. The two firms have fundamentally different business models. Starbucks is a vast global retailer, and the ambience of its stores matters as much as the taste of its coffee. Mr Illy is opening “Espressamente Illy” cafés with Italian styling in 18 countries, but these are chiefly intended as advertisements for the brand. Its main business is roasting and distributing a single blend of arabica coffee. Its customers are individuals and professional caterers, and the company reaches them by mail and through upmarket retailers.

Taking to heart his fashion analogy, Mr Illy has just been in New York to launch a promotion called “Beauty has a taste” at the Time Warner Centre. The event opened during the city's fashion week, and featured a range of collectable cups designed by leading artists, a book launch for the style editor of the *New York Times*—and, of course, free espresso. There was also a display of pictures of smiling workers in the various countries that grow Illycaffe's beans. The photographer was Sebastião Salgado, a Brazilian who is well known for his painful images of exploited workers in the developing world. The message was clear: like Starbucks, Illycaffe is keen to reassure customers that its coffee is produced according to the highest ethical standards.

Despite this, Mr Illy is sceptical about the influential Fairtrade movement, which tries to ensure that

farmers in the developing world make a reasonable profit regardless of fluctuations in prices on international commodity markets. Mr Illy complains that Fairtrade certification gives farmers a premium no matter what the quality, whereas to him, quality is everything. He does buy directly from growers, however, and to help them raise standards and earn more he has introduced an educational programme, devised by his University of Coffee in Trieste. More than 1,000 growers a year attend a one-day course at its São Paulo branch, and a team of nine agronomists travels the world providing training. Starbucks, which does sell lots of Fairtrade-branded coffee, similarly complains that there is not enough of it and that it is not available through long-term contracts.

Full of beans

Mr Illy, like his counterpart at Starbucks, Howard Schultz, is convinced that the growth of the market in gourmet coffee has only just begun. (Lest anyone think there are enough Starbucks outlets already, Mr Schultz expects the global total to rise from just over 12,000 today to at least 30,000, and probably many more.) Mr Illy says that his firm has quadrupled in size in the past ten years, not least by becoming a global brand. In the mid-1990s it exported to 12 countries, which accounted for about a fifth of sales; now Illy goes to 144 countries, which together account for 52% of revenues.

Mr Illy is optimistic for three reasons. He says that his firm is inching ever closer to delivering “perfection in every cup”. His particular obsession is with technical innovation. He claims (though some espresso-lovers dispute this), that Illycaffe has been responsible for three of the seven big innovations in coffee-making in the past century, as a traditional Italian craft has become an industrial process. The firm standardised espresso-making, and developed the paper pod containing a single dose of pre-ground coffee for an espresso machine. (Others invented decaffeination, instant coffee, multiple packets and liquid coffee.) Mr Illy is a chemistry graduate—at university he wrote a thesis on the “Quality of Espresso from a Chemical Perspective”—and is as enthusiastic about the science of coffee as he is about its taste. Now Illycaffe is implementing what it regards as its third big innovation. This is a two-stage espresso-making process involving “hyper-fusion” (which intensifies the drink's aroma), and “emulsification” (which makes it smoother).

He also points to the “massification of luxury”, a broad trend which should portend a boom in the number of people willing to buy expensive coffee. That could be reinforced by a growing belief that coffee is, in fact, good for you. As the chairman of the International Association on Coffee Science, a trade body, Mr Illy has just presided over a gathering of scientists which left him convinced that coffee is a powerful anti-oxidant, and can help in the fight against cancer, diabetes, Parkinson's disease and Alzheimer's disease. People used to think it was a poison, he says, and concern about its impact on health has hurt sales of coffee in the past. Now, he says, health is not an issue but an opportunity. Well, maybe.

Illycaffe's biggest challenge may be to produce enough high-quality coffee to meet growing demand. Reserves of beans are now at record lows: enough for less than four months' drinking worldwide, notes Mr Illy ominously. With oil prices falling, he predicts, hedge-fund speculators will soon be switching into coffee. Addicts should buy now, while stocks last.

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Virtual online worlds

Living a Second Life

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A Californian firm has built a virtual online world like no other. Its population is growing and its economy is thriving. Now politicians and advertisers are visiting

PETER YELLOWLEES, a professor of psychiatry at the University of California, Davis, has been teaching about schizophrenia for 20 years, but says that he was never really able to explain to his students just how their patients suffer. So he went online, downloaded some free software and entered Second Life. This is a "metaverse" (ie, metaphysical universe), a three-dimensional world whose users, or "residents", can create and be anything they want. Mr Yellowlees created hallucinations. A resident might walk through a virtual hospital ward, and a picture on the wall would suddenly flash the word "shitface". The floor might fall away, leaving the person to walk on stepping stones above the clouds. An in-world television set would change from showing an actual speech by Bob Hawke, Australia's former prime minister, into Mr Hawke shouting, "Go and kill yourself, you wretch!" A reflection in a mirror might have bleeding eyes and die.

When Mr Yellowlees invited, as part of a trial, Second Life's public into the ward, 73% of the visitors said afterwards that it "improved [their] understanding of schizophrenia." Mr Yellowlees then went further. For about $300 a month, he leases an island in Second Life, where he has built a clinic that looks exactly like the real one in Sacramento where many of his students practise. He gives his students "avatars", or online personas, so they can attend his lectures inside Second Life and then experience hallucinations. "It's so powerful that some get quite upset," says Mr Yellowlees.

Second Life, as Mr Yellowlees illustrates, is not a game. Admittedly, some residents—there were 747,263 as of late September, and the number is growing by about 20% every month—are there just for fun. They fly over islands, meander through castles and gawk at dragons. But increasing numbers use Second Life for things that are quite serious. They form support groups for cancer survivors. They rehearse responses to earthquakes and terrorist attacks. They build Buddhist retreats and meditate.

Many use it as an enhanced communications medium. Mark Warner, a former governor of Virginia who is considered a possible Democratic candidate for president in 2008, recently became the first politician to give an interview in Second Life. His avatar (also named Mark Warner) flew into a virtual town hall and sat down with Hamlet Au, a full-time reporter in Second Life. "This is my first virtual appearance," Mr Warner joked, "I'm feeling a little disembodied." They then proceeded to discuss Iraq and other issues as they would in real life, with 62 other avatars attending (some of them levitating), until Mr Warner

disappeared in a cloud of pixels.

By emphasising creativity and communication, Second Life is different from other synthetic online worlds. Most “massively multi-player online role-playing games”, or MMORPGs (pronounced “morpegs”), offer players pre-fabricated or themed fantasy worlds. The biggest by far is “World of Warcraft”, by Blizzard Entertainment, a firm in California, which has more than 7m subscribers. These worlds are the modern, interactive, equivalents of Nordic myths and Tolkien fantasies, says Edward Castronova, a professor at Indiana University and the author of “Synthetic Worlds: The Business and Culture of Online Games”. They allow players to escape into their imaginations, and to take part by, say, joining with others to slay a monster.

Making, not slaying

Second Life, by contrast, was designed from inception for a much deeper level of participation. “Since I was a kid, I was into using computers to simulate reality,” says Philip Rosedale, the founder of Linden Lab, the San Francisco firm that launched Second Life commercially three years ago. So he set out to construct something that would allow people to “extend reality” by building a virtual version of it, a “second life” not unlike that envisioned by Neal Stephenson in “Snow Crash”, a science-fiction novel published in 1992.

Unlike other virtual worlds, which may allow players to combine artefacts found within them, Second Life provides its residents with the equivalent of atoms—small elements of virtual matter called “primitives”—so that they can build things from scratch. Cory Ondrejka, Linden Lab's product-development boss, gives the example of a piano. Using atomistic construction, a resident of Second Life might build one out of primitives, with all the colours and textures that he would like. He might add sound to the primitives representing the keys, so the piano could actually be played in Second Life. “Of course, since these are primitives, the piano could also fly or follow the resident around like a pet,” says Mr Ondrejka.

Because everything about Second Life is intended to make it an engine of creativity, Linden Lab early on decided that residents should own the intellectual property inherent in their creations. Second Life now allows creators to determine whether the stuff they conceive may be copied, modified or transferred. Thanks to these property rights, residents actively trade their creations. Of about 10m objects created, about 230,000 are bought and sold every month in the in-world currency, Linden dollars, which is exchangeable for hard currency. Linden Lab estimates that the total value (in “real” dollars) this year will be about $60m. Second Life already has about 7,000 profitable “businesses”, where avatars supplement or make their living from their in-world creativity. The top ten in-world entrepreneurs are making average profits of just over $200,000 a year.

Second Life's total devotion to what is fashionably called “user-generated content” now places it, unlike other MMORPGs, at the centre of a trend called Web 2.0. This term usually refers to free online services delivered through a web browser—for example, social networks in which users blog and share photos. Second Life is not delivered through a web browser but through its own software, which users need to install on their computers. In other respects, however, it is now often held up as the best example of Web 2.0. “It celebrates individuality,” says Jaron Lanier, who pioneered the concept of “virtual reality” in the 1980s and is now “science adviser” at Linden Lab. And it connects people, he says, because “the act of creation is the act of being social.”

By emphasising creativity and communication, Second Life is different from other synthetic online worlds

The Web 2.0 crowd also extols Second Life for its highly original business model. Most Web 2.0 firms try to build audiences around user-generated content in order to sell advertising to them. This assumes the availability of unlimited advertising dollars, a notion that is increasingly ridiculed.

Linden Lab does not sell advertising; instead it is a virtual property company. It makes money when residents lease property—an island, say—by charging an average of $20 per virtual “acre” per month. Only about 25,000 residents, or about 3% or the population, lease property, but that already amounts to 53,800 acres, which, in real life, would be bigger than Boston. This works out to monthly revenues of $1m, not counting the commissions that it takes on currency exchanges between Linden dollars and hard cash. As a private company, Linden Lab does not disclose its exact revenues, although Mr Rosedale says the firm is “close to profitability”.

A common reaction to such numbers is astonishment that anybody should pay anything at all for

something that exists only in a metaphysical sense. But “there's actually no economic puzzle in this; all kinds of things derive their economic value only from the realm of the virtual,” says Indiana University's Mr Castronova. The American dollar, for instance, is virtual (aside from the value of the paper used for the bills) in that it requires consumers to have faith in its worth. In the context of online games, virtual economies much bigger than Second Life's have existed for years. Many people in poor countries, called “gold farmers”, play games such as “World of Warcraft” professionally to score weapons, points or lives to sell to lazier players in rich countries. But Second Life is unique in that residents conceive what they sell. As such, says Mr Lanier, it is “probably the only example of a self-sustained economy” on the internet.

For all these reasons—its ability to change the real lives of its residents, its innovations in technology and in its business model—Second Life has become a darling of Silicon Valley. It promises to be “disruptive”, says Mitch Kapor, the inventor of the Lotus spreadsheet that played a big role in the personal-computer revolution of the 1980s and 1990s. He is now chairman of Linden Lab. To him, Second Life is comparable to both the PC and the internet itself, which started as something “quirky” for geeks, and then entered and transformed mainstream society. “Spending part of your day in a virtual world will become commonplace” and “profoundly normal,” says Mr Kapor. Ultimately, he thinks, Second Life will “displace both desktop computing” and other two-dimensional “user interfaces”. As “a hothouse of innovation and experiment,” he says, Second Life may even “accelerate the social evolution of humanity.”

Back to this reality

It is bold and early to make such predictions. After all, Second Life is still a relatively small virtual world—only about 9,000 residents are usually logged in at any one time, for example. About two-thirds create content from scratch, but mostly they customise things that they find or browse passively. And a lot of the wares on offer are banal. Whereas a few residents choose very innovative bodies for their avatars, most have shapes, male and female, that hew to the default templates and look, predictably, like cosmetically enhanced porn stars. Among the artefacts, there is some genuine art but quite a bit of junk.

Endless possibilities: Donna Meyer, a grandmother from New York, and her avatar

Is Second Life a nirvana where unknown talent can prove its creative mettle and make it in the real world? “You can create your own island and people come to it,” said Bill Joy, a co-founder of Sun Microsystems and now a prominent venture capitalist. But “I don't see any correlation between that and what it's going to take to be a designer and have a skill set to succeed in the world.”

Mr Castronova also cautions against overestimating the depth and breadth of Second Life's economy. Yes, people do create clothes and games and spacecraft in Second Life and then sell them. But most of the big money comes from the virtual equivalent of land speculation, as people lease islands, erect pretty buildings and then rent them to others at a premium. Tongue in cheek, Mr Castronova compares Second Life's in-world boom to America's house-price bubble. In artistic terms, there is not always much difference between building an in-world house and designing a personal web page.

There are also stirrings of discontent among some of the “older” (if one can use that term in a three-year-old metaverse) and more purist residents of Second Life about what they see as a menacing trend toward commercialism. One avatar, for example, has created “MetaAdverse”, a network of advertising billboards inside Second Life to which property developers can feed images of their creations. More

controversially, Second Life is also attracting the attention of corporations and advertisers from the real world hoping to attract the metaverse's residents. Publishers now organise book launches and readings in Second Life. The BBC has rented an island, where it holds music festivals and parties. Sun Microsystems is preparing to hold in-world press conferences, featuring avatars of its top executives. Wells Fargo, an American bank, has built a branded “Stagecoach” island, where avatars can pull Linden dollars out of a virtual cash machine and learn about personal finance. Starwood, a hotel and resort chain, is unveiling one of its new hotels in the virtual world.

Toyota is the first carmaker to enter Second Life. It has been giving away free virtual vehicles of its Scion brand and, in October, will start selling all three Scion models. The price will be modest, says Adrian Si, the marketing manager at Toyota behind the project. Toyota really hopes that an “aftermarket” develops as avatars customise their cars and sell them on, thus spreading the brand “virally”. Toyota will be able to observe how avatars use the cars and might, conceivably, even get ideas for engineering modifications in the real world, he says.

Those Scion cars have “great driving performance for in-world physics,” says Reuben Steiger, the boss of Millions of Us, a company he founded this year to bring companies like Toyota into Second Life for marketing and brand-building. “How it corners and makes sounds when it changes gears is great.” So Toyota, which is a client of his, along with Sun Microsystems and even Mr Warner, shows that Second Life is “perfect for creating experiences around a brand,” says Mr Steiger. “We don't think that conventional advertising will be very prevalent,” he says, because it would “be badly received culturally”. Advertising in Second Life is not about “trapping people” but about captivating and stimulating them. A good campaign in Second Life costs about $200,000 dollars, he reckons, of which only a tiny part is property leases and most goes to paying the talented designers to create great virtual stuff.

Virtual strip mall?

Inevitably, this sort of thing turns some residents off. Will Second Life, that realm of individualism and pure creativity and spontaneity, get plastered over by the same mega-brands and mass culture that have, arguably, made the physical world such a homogenous place? In real life, many avatars argue, big business tends to push out small artisans. If the same happens in Second Life, the metaverse will lose its raison d'être.

Mr Rosedale, Linden Lab's founder, empathises with the concern, but thinks it is misplaced. “That is a fear which comes from the real world that is not likely to be borne out in Second Life,” he says. His arguments are all economic. In the physical world land is scarce, so big brands can buy up much of it; in Second Life, Linden Lab simply allocates more computer-processing power and makes even more islands available. The world is infinitely expandable, in other words. If one patch did become homogenous and drab, avatars would simply fly off to the next.

Another economic difference, says Mr Rosedale, is the lack of economies of scale in Second Life. In real life, a shoemaker, say, can reduce the average cost of making a pair by producing huge amounts, and the average cost of marketing by buying advertising in bulk. In Second Life, however, scale means nothing. There is no manufacturing cost to minimise. Gimmicks, such as giving away free shoes, are useless because nobody actually needs shoes at all. Nike, say, has no inherent competitive advantage over a hobbyist who likes to design shoes (or feet, paws, wings or claws) for fun. Thus, says Mr Rosedale, whereas the physical world has relatively few things that are sold in huge numbers, Second Life has huge numbers of things that are sold in relatively small quantities. In the statistical jargon, Second Life's economy trades in “the long tail” of things.

This is why, for the time being, Mr Rosedale prefers to rule Second Life with Adam Smith's “invisible hand” only. To him that means treating every resident the same, whether it happens to be Toyota or “an 80-year-old woman from India.” Both will pay the same price for their acres; what they do with it is up to them. If it ever became necessary, he adds, Linden Lab could “become a regulator and break up monopolies”, but this does not seem likely to come about.

How, then, is one to make sense of Second Life? For those new to it, it appears to be too mind-boggling to have much relevance to real life. For those who spend time inside, however, Second Life ironically tends to resemble the real world even as its obvious differences become clear. Mr Kapor, Linden Lab's chairman, is the first to agree. “People bring all their karma” into the world, he says. Alongside benevolence, there is harassment. If Second Life were ever to become truly mainstream, there is no guarantee that residents would not pollute it with racism and hatred. Perhaps crime too: residents had to

reset their passwords after a recent hacking attempt.

These things may be a criticism of human nature, but it cannot be blamed on Second Life. Henry Jenkins, a professor of media studies at the Massachusetts Institute of Technology, thinks that Second Life deserves credit as “a world of hypotheticals and thought experiments.” From new approaches to corporate branding to education, Second Life is a petri dish for innovations that may help people in real life. Already, therapists are using Second Life to help autistic children, because it is a safe environment to practice giving signals to others and interpreting the ones coming back. Other organisations are using Second Life for long-distance learning. Overall, says Jaron Lanier, the veteran of virtual-reality experiments, Second Life “unquestionably has the potential to improve life outside.”

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Currency markets

Yen and yang

Sep 28th 2006 | HONG KONG
From The Economist print edition

China-bashers may soon take aim at the yen, the world's most mispriced currency

Get article background

WHICH country has the world's most undervalued currency? Most people would answer China. Yet by many measures the Japanese yen is now cheaper than the Chinese yuan. It cannot be long before America and Europe put Japan in the dock, alongside China, and accuse it of keeping its currency unfairly low.

Until this year the yen's weakness was easy to explain: since 2001 the Bank of Japan (BoJ) had been printing loads of money in order to defeat deflation. An increased supply of yen relative to that of other currencies pushed down its price. But the yen's softness this year is a puzzle. Since the BoJ abandoned "quantitative easing" in March, Japan's monetary base has withered. Deflation has gone away, and in July the BoJ raised interest rates, which had been stuck at zero for five years. Furthermore, Japan had a whopping current-account surplus of $165 billion in the year to July (the latest figure for China, for 2005, is only $161 billion, although it is expected to rise in 2006). In many respects, the yen should be climbing.

Instead, since March it has fallen slightly against the dollar and by as much as 8% against the euro, which fetched a record ¥150 earlier in September, before edging back up a bit. Since mid-2001 the yen has fallen by around 35% against the euro, while against the weaker dollar it is little changed. Japanese exporters have also gained competitiveness relative to South Korea, where the won has risen strongly against the dollar during the past year.

Not only is the yen cheap in nominal terms, but many years of falling prices in Japan have made it even more competitive. Its real trade-weighted value fell this month to its lowest since 1982 (see chart). The latest update of *The Economist*'s Big Mac index (see article) showed that the yen was by far the most undervalued of the developed world's currencies—ie, hamburgers are cheapest in Tokyo. Using a more sophisticated model, Stephen Jen, of Morgan Stanley, reckons that the yen is 12% undervalued against the dollar, whereas the yuan is only 7% too weak. Against the euro, the yen is almost 30% below its fair value.

If the yen is the most mispriced currency on the planet, why are Japan's trade partners not complaining loudly, as they do about the yuan? Some European finance ministers and central bankers, including Jean-Claude Trichet, the president of the European Central Bank, have started to argue recently that the yen is not bearing its fair share of the dollar's decline. But a big difference between Japan and China is that the yen floats freely and is not being held down by currency intervention as it was back in 2003-04.

Such a cheap currency might seem a good investment. But to predict where the yen is heading, you have to understand why it is so weak today. One reason is that at 0.25%, Japanese interest rates are still unattractive. And inflation has gone up by more than the quarter-point rise in Japanese interest rates, leaving real rates close to zero and even lower than last year.

The most popular explanation of the yen's languor is a revival of the “carry trade” (ie, borrowing in cheap yen to buy higher-yielding investments elsewhere). This means selling the currency and thus pushes it down. In the past month or so, carry trades have become more attractive; the expectation that the BoJ would raise interest rates again this year has faded as a result of slower economic data. If this is the case, at some stage the yen could rebound sharply if America's economy stumbles and falling American interest rates narrow the gap with Japan's.

However, Mr Jen is sceptical that the carry trade is the main culprit. He reckons that most investments have gone into dollars not euros, and so cannot explain why the yen has gained against the European currency. Moreover, net outflows from Japan of investment in fixed-income bonds have actually declined this year—especially in the past few months.

Mr Jen has an alternative explanation for why the yen is so feeble against the euro: the “global funnelling hypothesis”. This focuses on the net trade and capital flows of Asian and oil-exporting countries, which could run a combined current-account surplus of around $900 billion this year. In simple terms, the world buys from these countries and they then invest the net proceeds in financial markets.

Most international trade is settled in dollars or euros, so importers have to sell their local currencies in order to buy from abroad. Mr Jen calls these “upstream currency flows”. “Downstream flows”, in contrast, are what Asia and oil exporters do with their accumulated reserves. The currency compositions of the two flows do not necessarily match.

Because Asian countries trade a lot with each other, the bulk of upstream flows involves the selling of yen and other Asian currencies. In contrast, most downstream flows go into dollars and euros. Central banks prefer to put money into well-developed financial markets, so the liquid and secure markets of America, the euro area and Britain attract more capital.

This causes a funnelling from Asian currencies into dollars and euros. Emerging economies' rising foreign reserves therefore push the yen down against the euro, regardless of fair-value calculations. This also explains the strength of the pound. Recent figures show that it has knocked the yen off its perch as the world's third most popular reserve currency.

If correct, this theory suggests that the yen could remain weak for longer than many analysts expect. In the long term, however, the yen's huge undervaluation means that it will eventually bounce back. Last week was the 21st birthday of the G7's Plaza Accord, which triggered a huge rise in the yen. The yen is much more undervalued today than it was then.

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About sponsorship

Oil

The heat is off

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From The Economist print edition

Falling oil prices cheer central bankers

IN THE eyes of Edmund Daukoru, Nigeria's oil minister and the current president of the Organisation of the Petroleum Exporting Countries (OPEC), the price of oil is “very low”. Compared with July, when it peaked at $78.40 a barrel, he is right. Since then, it has fallen by almost a quarter. On September 25th, it briefly slipped below $60 a barrel, its lowest level in six months. The same analysts who just a few short months ago were wondering about the effect of expensive oil on the world economy are now pondering the consequences of a slump.

That might prove premature. For one thing, Mr Daukoru insists that OPEC will do something to stem the slide. At its last meeting, in mid-September, the group threatened to cut its output without notice if the price fell further. Saudi Arabia, for one, has been selling less oil of late. Ministers from different OPEC countries have been making different noises about whether a cut is desirable or likely, but all would be loth to see their revenues eroded by lower prices.

The world is still consuming almost as much oil as it can pump, so any reduction in supply could send prices skywards again. Both the relative calm of this year's hurricane season and the diminishing threat of an interruption to Iran's oil exports seem to have contributed to the recent fall. But should clouds gather over the Atlantic, or tempers rise in the Middle East, the price could jump again.

Moreover, the price of oil usually falls in the autumn, after the summer surge in petrol consumption has abated but before winter brings higher demand for heating oil. According to Sabine Schels, a commodity strategist at Merrill Lynch, seasonal swings in fuel prices are becoming more pronounced, thanks to a shortage of refining and storage capacity. At times of peak demand, she argues, the petrol price must rise high enough to prompt the reopening of old and inefficient refineries that would not normally be profitable. Those refineries, in turn, use up a lot more oil, pushing up its price too.

Oil markets will not escape this cycle, Miss Schels believes, until more refineries and storage tanks are built, and more fields developed—a process that can take years. Traders in the futures market also seem to believe that the oil price will rise again. Oil for delivery in December 2007, for example, cost $68 on September 27th. The price is more than $60 for all months until December 2011.

Those bets could sour, however, if the American economy slows, as many suspect it is already doing (see article). That would dent demand for oil, both from America itself and from countries that supply it with imports, such as China. Economists at HSBC, who expect a sharp American slowdown in 2007, now think Asian GDP growth will be 5.8% in 2007, against the consensus forecast of 6.3%.

On the other hand, cheaper oil might help to mitigate any slowdown, in several ways. It would boost firms hit by higher energy prices, such as the struggling manufacturers of gas-guzzling cars. And it will relieve the pressure on consumers, at a time when many are worried that a stalling housing market may weigh on their spending. Economists at Morgan Stanley estimate that the fall in petrol prices from over $3 to $2.50 a gallon (the average is now $2.42) will alone have added some $78 billion to American purchasing power. Consumer confidence numbers, released on September 26th, were unexpectedly strong.

Above all, cheaper oil would ease concerns about inflation, and so reduce the need for central bankers to increase interest rates. American inflation slowed in August, thanks in part to smaller increases in the cost of energy and transport. That's good news, except that it might simply prompt Americans to drive more.

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Private equity

Club class

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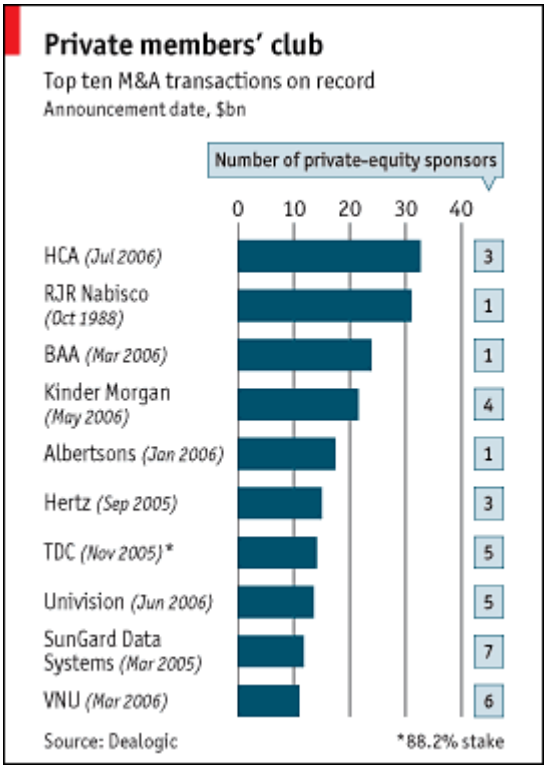
In a hard-nosed world, buy-out groups are showing unusual friendliness



BACK in 1988, when Kohlberg Kravis Roberts (KKR) made its staggering $31.1 billion bid for RJR Nabisco, the buy-out world was dominated by a relatively small group of investors, nearly all on first-name terms but fiercely competitive.

Nearly two decades later, the volume of cash coming into private equity has ballooned—$300 billion-worth of buy-outs were done in the first half of this year, almost matching the amount for the whole of 2005. Yet in this cut-throat world, a strange sort of clubbiness has emerged at the top. While smaller firms slug it out vehemently, the big boys appear to have adopted an unwritten code that allows them to bid against each other one moment and team up the next. Six big private-equity firms—KKR, Blackstone, Bain Capital, Carlyle, Texas Pacific Group (TPG) and Permira—have taken part in $119.8 billion-worth of deals of more than $10 billion apiece in the past 18 months with each other or with other firms.

This month's bidding for Freescale Semiconductor, a chipmaker, highlights the trend. Freescale's board has accepted a $17.6 billion offer from a consortium led by Blackstone (joined by TPG, Carlyle and Permira), but has also left the door open to a rival group, made up of KKR, Bain, Apax Partners and Silver Lake Partners. Although Blackstone and KKR were on opposite sides here, figures from Dealogic, a data provider, show that they have teamed up to invest in three other $10 billion-plus deals in the past year and a half.

Several factors are behind the trend toward “clubbing”. First, the sheer amount of money pouring into private equity means big firms are looking for places to spend it (several of them have raised $15 billion or more in recent funds), yet many have caps on how much can go into a single deal. Joining forces allows them to share costs and risks, not to mention strengths: firms like Providence Equity Partners are known for their sectoral expertise (telecoms), while Blackstone and KKR are all-rounders with deep pockets.

As firms look for ever-bigger deals—driven by attractive price/earnings multiples and a good turnaround track record—there is also a desire by the other big players not to be left out. “There's a bit of ‘I'll show you my deal if you show me yours’,” says one partner in a big firm. Post-deal syndication—selling off pieces to minority partners—is another way to keep potential rivals sweet. Much to the frustration of investment bankers and their clients (the sellers), who privately accuse the clubs of acting more like cartels, bidding consortia are also seen as a possible way to decrease the prices paid at auction.

Yet such groups bring their share of challenges. “A major problem in club deals is you have so many cooks,” says Senia Rapisarda of London Business School's private-equity centre. She points to potential disagreements over price, management decisions, and exit strategies. “These definitely dilute some of the efficiencies” in private-equity investing. It is not uncommon for firms to drop out of club bids along the way, although keeping a good name is essential in such a tightly knit group of people.

There have been no disasters among the consortia so far, but sooner or later something is likely to go

wrong. “Teaming up is always good in the good days, but it becomes very ugly in the bad days,” says a partner in a big private-equity firm. Others warn of the dangers of doing big transactions at very high multiples.

For investors eager to put more money into private equity, the club deals have raised concerns about risk concentration. There are other worries as well. “If five firms are investing in one deal, you can be pretty sure two or three are not doing thorough due diligence,” says Steven Kaplan, a finance professor at the University of Chicago's business school.

Simon Perry, head of Ernst & Young's global private-equity practice, suggests that “club” may be the wrong term for these alliances. “‘Club’ engenders a warm, slipper-like feeling,” he says. “These are well-run, profit-oriented organisations that are finding it in their self-interest to associate.” In other words, in harder times the friendliness may wear off fast.

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Buttonwood

Mixed messages

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Bond investors are probably right to fear an American slowdown

WHEN asset classes diverge, investors should take note. Bond yields have fallen sharply in recent weeks, with the ten-year treasury bond yielding 4.53% on September 25th, compared with 5.24% in June. That, and the recent weakness in commodity prices, might seem to indicate an imminent economic downturn.

But investors in shares do not seem overly concerned. The Dow Jones Industrial Average has been flirting with its record high of 11,722, set back in January 2000. The Belgian and Spanish stockmarkets have recently scaled new peaks. And emerging-market bond spreads, a good indicator of investors' attitude to risk, are around their lowest levels of the past 14 years.

The stockmarket bulls feel there is little to worry about. Profits growth has far outstripped share prices in recent years, bringing price/earnings ratios down significantly. And company cashflows are so strong that, according to James Montier of Dresdner Kleinwort, American share buy-backs are adding three percentage points to the dividend yield.

Profits look high as a proportion of GDP, in historical terms, but the bulls feel there is little sign of an imminent reversion to the mean. The global economic outlook may have moved in favour of companies because globalisation has reduced wage pressures.

Indeed, the bulls feel stockmarkets would have been even higher but for investor concern about geopolitical risk, high oil prices and rising interest rates. Now that oil prices have recently dipped below $60 a barrel and American interest rates may have peaked, the markets can put those worries behind them.

Indeed the drop in the oil price may have played the role of the Seventh Cavalry, riding to the rescue. Lower petrol prices may relieve the pressure on American shoppers (as shown by this week's rebound in consumer confidence). In addition, by bringing down headline inflation, central banks will have fewer reasons to tighten monetary policy.

So what are bond investors worrying about? If the recent fall in oil is actually a sign of a slowing global economy, a more apt equine analogy might be a horseman of the Apocalypse. Recent American data, such as last week's survey from the Federal Reserve Bank of Philadelphia, have generally been weaker than expected. Goldman Sachs is expecting third-quarter American output growth to be just 2% (annualised), well below trend.

The big concern is the American housing market (see article). August existing home sales data were a little stronger than expected, but median sales prices are lower than they were a year ago, the first annual decline since April 1995.

Some analysts dismiss housing worries, pointing to Britain and Australia, where a sudden slowdown in house prices prompted a softening, but not a collapse, in household consumption. But David Bowers of Absolute Strategy Research argues that the British and Australian economies benefited from America's strength when they were under pressure. No other economy can give America the same support. In addition, the construction sector is a more important provider of American jobs than its British or Australian equivalents.

A housing-market decline will be a balance-sheet shock for American consumers that might prove the final spur for them to do what some have predicted for years; rebuild their savings. Unfortunately, this hit to demand could coincide with problems elsewhere, with Germany facing a value-added-tax increase

in 2007, Japan's recovery faltering a little and the Chinese attempting to slow their investment boom.

This sudden change in the bond market's focus might seem rather strange; after all, only a month or two ago investors were worrying about inflation. And some analysts cling to the view that bond investors are underestimating the inflationary potential and that, after a brief pause, the Fed will be forced to resume raising American interest rates. A slight variation of this argument is that the inflationary pressures will prevent the Fed from being quite as accommodating if the economy turns down.

It is hard to see how both the bond and equity markets can be right. Equity investors seem to assume that the global economy will display the same resilience as it has in recent years; taking that view has been a bet that has paid off since 2003. But the bond markets almost have an each-way bet on a slowdown: “Ashes to ashes, dust to dust, if the Fed doesn't get you, then housing must.”

The forecasting record of bond markets is not perfect: remember the deflation scare of 2003? But given the scale of the decline in yields, and the fickleness of stockmarkets, it would be foolish to bet against the bond market's judgment.

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Alternative investments

Doing well by doing good

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Two studies find merit in private equity and hedge funds

THE boom in alternative investment vehicles such as private-equity firms and hedge funds is wonderful for those who earn a fortune working for them. More debatable is whether it is good for the efficiency of the capital markets, and thus for the economy as a whole. Private-equity firms have been accused of wrecking companies since the 1980s, if not before. Hedge funds have come under heavy fire since George Soros forced sterling out of Europe's exchange-rate mechanism in 1992.

However, two new economic studies cast them in a more positive light. In “The Performance of Reverse Leveraged Buyouts”, Jerry Cao and Josh Lerner investigate the allegation that private-equity firms weaken the companies they buy—taking them private, running them to maximise short-term cash flow, burdening them with debt, then flogging them to gullible investors through an initial public offering (IPO).

In their study, the two economists examine the post-IPO performance of 496 firms floated by private-equity companies between 1980 and 2002. They found that these shares outperformed both the overall stockmarket and shares issued in other IPOs not backed by private equity. Highly leveraged firms performed no worse than those with less debt. Bigger IPOs backed by private equity did even better than smaller ones. However, those firms that were owned by private equity for less than a year performed relatively poorly, suggesting that “buying and flipping” back to the market—common nowadays—is a less useful role for private equity to play than longer-term ownership.

The second study examines the growing fashion for hedge funds to target companies in an effort to get them to change strategy and/or top management. In “Hedge Fund Activism, Corporate Governance, and Firm Performance”, Alon Brav, Wei Jiang, Frank Partnoy and Randall Thomas examine 374 such efforts in 2004-05 by 110 activist hedge funds, which acquired at least a 5% stake in their targets. Around 40% of their interventions were hostile, resisted by the incumbent company management. The good news: shares in the target firm outperform the market over various periods, including by 5-7% in a 20-day window around the start of the activism. The best performance occurs when the hedge fund attempts to get the target to change its strategy or put itself up for sale. There is little upside in simply trying to change the target's capital structure.

The authors conclude that there is “no empirical evidence for the assertion that hedge fund activism destroys value or is short term in focus.” Not so bad then, after all.

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Deutsche Bank

Legally bound

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Are the legal hassles of Deutsche Bank's bosses harming its future?

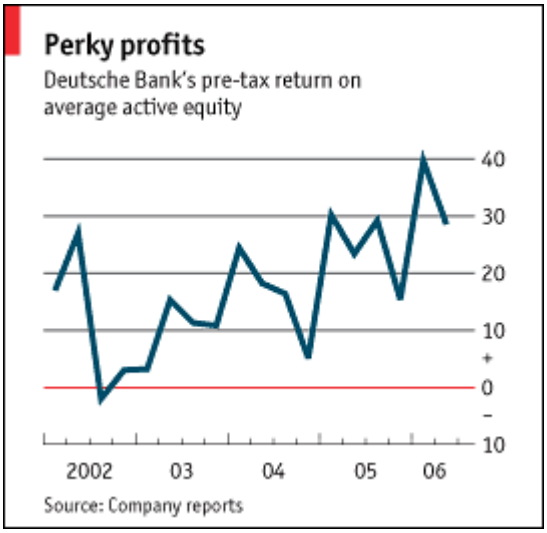
NO DOUBT about it, Deutsche Bank is at last in a league that befits Germany's biggest bank. Globally, it leads the field in foreign exchange and aspects of debt and derivatives. Thanks to its ambitious investment bankers in London, it is developing a healthy obsession with being classed among the best in the world.

Why then, is Josef Ackermann, its chief executive, apparently reluctant to take it one step further and find a merger partner? Recently, he said that sheer size, in terms of market capitalisation, is not the right yardstick to measure the bank's might. He may be right. But in many respects, Deutsche Bank remains too small.

There are, for example, gaps in its coverage in America and Japan, in launching share issues and in advising companies on strategy. It does not have the capital or clients of heavyweight rivals such as Citigroup and JPMorgan Chase in America, and UBS closer to home, which could help it withstand a serious storm.

As yet, its profitability remains good; it has recently turned in some strong quarterly results (see chart). It is also, according to published value-at-risk figures, taking smaller bets on its own account than investment banks, such as Goldman Sachs or JPMorgan, so is less exposed if the markets turn against it.

The London investment bank could do with more support, however, from the other divisions of Deutsche Bank: for instance its global private-banking business, asset management, and retail banks in Germany, Italy and Spain. The one German jewel is DWS, the subsidiary that manages German mutual funds. DWS provides the investment bank with opportunities to sell it derivatives. Deutsche Bank wants to extend its investment-banking expertise to other retail products, such as mortgages, via securitisation.



In the past few months, it has committed more resources to making the domestic bank bigger. It bought Berliner Bank in June, adding 300,000 affluent customers in the German capital. In August it bought the business and branches of norisbank, with 334,000 clients, which it hopes will give two foreign interlopers, Citibank and ING Diba, a run for their money.

This renewed enthusiasm for banking on German soil may, or may not, reflect efforts by Mr Ackermann, a Swiss, to endear himself locally. On October 26th he faces a retrial of the Mannesmann case, in which he and five others are accused of awarding €57m ($53m) of unwarranted bonuses in the wake of Vodafone's hostile takeover of Mannesmann in 2000. Mr Ackermann sat on Mannesmann's supervisory board. There is no obvious successor should he be convicted and forced to resign.

This and other litigation continues to distract top management from the task of building up the bank. Rolf Breuer, the former chief executive, and the bank itself are fighting accusations that his untimely comments precipitated the bankruptcy of the Kirch media group in 2002. Leo Kirch, its former boss, continues to dog Deutsche Bank with legal claims. Via a Frankfurt court he forced it to disclose how much it pays the six non-board members of its group executive committee, where the real moneymaking

power lies. Answer: around €90m last year.

AP

Ackermann is still smiling

Mr Kirch's latest initiative has prompted Berlin prosecutors to examine circumstances leading to the appointment of Caio Koch-Weser, a former state secretary of finance, as an adviser to the bank with the title of vice-chairman. Various decisions to the advantage of Deutsche Bank, including a joint mandate to securitise Russian debt, were made at the finance ministry during Mr Koch-Weser's tenure.

Deutsche Bank says it is too small to play the lead role in consolidating the European banking industry. At home it fears a merger with Commerzbank, another big bank, would mean a bloodbath of lay-offs but no substantial increase in its share of a horribly fragmented market. Instead, it has chosen to grow in small steps; it recently bought MortgageIT Holdings, an American mortgage company.

Abroad, there are merger opportunities—and complications. Credit Suisse, for example, might be a candidate. The banks have similar cultures and would complement each other, albeit with some overlap, in banking and investment management. Mr Ackermann, however, was ousted as Credit Suisse's chief executive in 1996, and might not be welcomed back. Merrill Lynch is deemed too big. Citigroup was once a possibility, but proved politically unacceptable in Germany.

With their minds on other things, it is no wonder Deutsche's bosses have no taste for such big mouthfuls. On the other hand, they run the risk of failing to grow as solidly as their chosen competitors.

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Banks and hedge funds

Blank cheques and balances

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Lenders to hedge funds need to think harder about the risks

EIGHT years ago, when Long-Term Capital Management (LTCM), a fabulously well-connected Connecticut hedge fund, was holed by an explosive mix of bad bets and borrowed money, the Federal Reserve was forced to bail it out. Its brokers, who had virtually written it a blank cheque, were in a panic: of LTCM's $125 billion in investments, $120 billion was backed by borrowing.

In September, news that Amaranth, another Connecticut hedge fund, lost $6 billion, 65% of its value, in less than a month caused barely a ripple in financial markets. Whether due to good luck or judgment, its brokers managed to recoup the money they had lent the hedge fund without losing a penny.

This, say prime brokers, shows how their risk-management systems have improved since LTCM. Hedge-fund managers, with one eye on a proposal winding through Congress that would compel federal agencies to look into the need for hedge-fund regulation, claim they, too, have improved checks and balances.

Banking supervisors aren't so sure. Increasingly, they are urging regulated banks, which lend to hedge funds through prime-brokerage units, to be more vigilant about the risks being taken with the banks' money. The problem is, managing risk is as much art as science.

When lending to hedge funds, prime brokers must decide how much to lend against a borrower's collateral. Then they must monitor this collateral so that, should it deteriorate, brokers can demand more of it or call in loans.

Both tasks are tricky. For one, hedge funds routinely use several prime brokers—and each broker sees only the securities he lends against. Hedge funds also increasingly invest in esoteric derivatives that are often illiquid and difficult to value. Moreover, the “quality” of collateral is not static. It deteriorates—and lending must be reduced—if, say, a trade or strategy is popular with other investors (a “crowded trade”); liquidating such trades in times of market stress is exceedingly difficult.

This means, says Tanya Beder, an investment-management expert who resigned as the head of one of Citigroup's in-house hedge funds two weeks ago, that big prime brokers can benefit from “informational economies of scale”: they see more data and so can better discern market trends. Still, the sophisticated computer models that banks use to crunch data have limits; a model is only as good as the inputs it gets.

So far, the market seems to have absorbed the shocks from Amaranth and Refco, a futures trader where accounting fraud was uncovered last year. But standards are not set in stone. Some worry they might yet be loosened as new firms attempt to take on the established prime brokers—and cut corners to compete. Also, would markets have been nearly as composed if Amaranth and Refco had melted down at the same time?

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Economics focus

Curve ball

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A link between unemployment and inflation is fashionable again

IF HAIRCUTS and dress styles can come back into fashion, then so can economic theories. That is why policymakers have recently been debating the implications of the shape of that very 1960s concept, the Phillips curve.

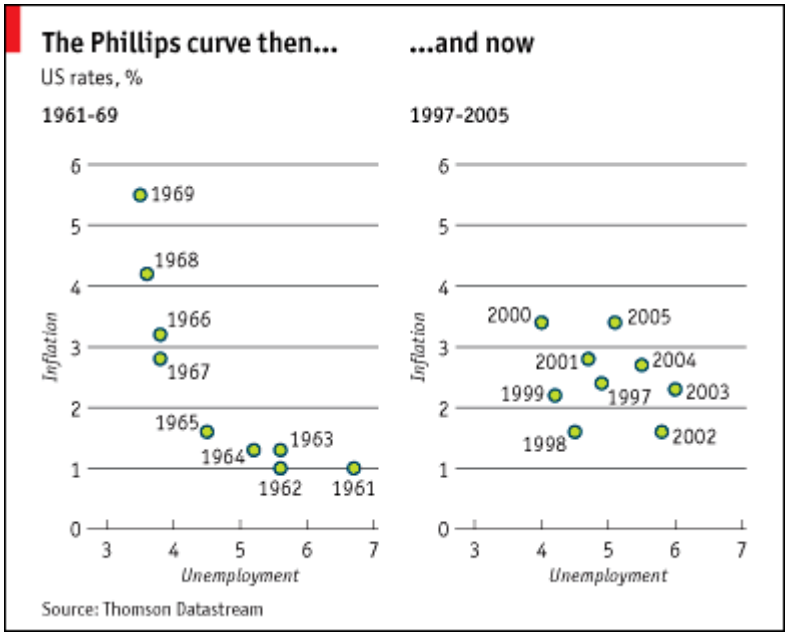
The Phillips curve was named after A.W. Phillips, whose research suggested a trade-off between British unemployment and wage inflation over the period 1861 to 1957. The curve was widely used in the 1960s. Economists developed models that gave politicians a neat way to find the right balance between the two factors; for every percentage-point fall in unemployment, inflation would rise by, say, half a point.

But in the 1970s, the trade-off between unemployment and inflation seemed to evaporate; both rose at the same time, a phenomenon known as stagflation. As Stephen King, chief economist at HSBC, says, “The Phillips curve relationship did exist as long as governments weren't perceived to be exploiting it. When they did, they ended up with accelerating inflation.”

Even before the curve began to break down in practice, Milton Friedman had cast doubt on the theory, as had Edmund Phelps, another American economist. The doubters argued that workers would demand higher wages to protect themselves against the rise in inflation. Thus the only effect of government stimulus would be to increase inflation for the same level of employment; in the long run, the Phillips curve became vertical.

So the Phillips curve fell out of favour and was replaced by its corollary, the NAIRU, or non-accelerating inflation rate of unemployment (in effect, the natural rate). Economists spent much of the 1980s and 1990s debating what the rate might be. In the late 1990s indeed, many forecast that the Federal Reserve would be forced to raise interest rates to counter inflationary pressures when unemployment fell below 6% (and then 5%). But the Fed decided that productivity improvements had driven down the NAIRU and so left policy on hold. Growth duly flourished without causing inflation at the consumer level—although some argue that the laxity of monetary policy caused the tech bubble.

Why has the Phillips curve, displaced by the NAIRU and the output gap (which suggests that inflation will rise when economic growth is above trend), come back into the economic debate after so long in the cold?



In part because, while the NAIRU and the output gap are nice ideas, it is often hard to agree, at any given moment, on the value of either number. But the main reason is that the relationship between unemployment and inflation has settled down again. Low unemployment has not been accompanied by significant increases in inflation; in other words, the Phillips curve has flattened considerably.

A fillip for Phillips

Most commentators have put this down to globalisation. As Paul McCulley, a strategist at PIMCO, a large American fund-management firm, remarks in his latest commentary: “The Fed need not worry that a falling US unemployment rate will quickly generate a rapid acceleration in US wage-driven inflation, as US labour's pricing power is diminished by competition from an augmented global labour supply.”

A flatter Phillips curve is good news when unemployment is falling. But it also implies bad news if inflation rises significantly. It would then take a much larger increase in unemployment (a more severe recession) to bring inflation down again. This may explain why the European Central Bank has found it so difficult to get euro-zone inflation back below its target of 2%.

This is where the credibility of a central bank may matter a lot. If consumers believe the central bank will keep inflation low, then they will not react to temporary shocks (such as high oil prices) by demanding higher wages. Mr King says it is all down to “rules of thumb” concerning the likely level of inflation. “It is easier to control inflation if the public has the same rule of thumb as the central bank. But if the public adopts a different rule, notably that inflation will be higher, the task of the central bank becomes much more difficult.”

That makes it all the more important to decide exactly why the Phillips curve has flattened. In particular, are central banks responsible for the favourable trade-off between unemployment and inflation over the last ten years? Or, as Ken Rogoff of Harvard University suggested recently*, have policymakers merely had a dash of luck: that globalisation happened to coincide with the independence of central banks?

If the answer is luck then central banks need to be on their guard, especially as headline rates of inflation have been rising recently. Some, including the Bank of England, seem to have recognised this problem. They say that while globalisation has caused the prices of manufactured goods to fall, the corollary has been that sharply higher demand for raw materials has caused commodity prices to rise sharply. Core inflation numbers, which exclude food and energy, may thus reflect the good news about globalisation, but ignore the bad.

The Federal Reserve may focus on the low core rate of inflation but workers may be watching the headline numbers, which in most countries have been significantly higher. The sharp drop in oil prices in recent weeks may reduce this differential, but could easily be reversed by supply disruption or a harsh winter.

If workers begin to focus on the effect of higher commodity prices on their spending power, and regard the effect as permanent rather than temporary, then they may push up their wage demands. That could lock higher inflation into the system, giving central banks a devil of a job to bring it back down again.

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*"Impact of Globalisation on Monetary Policy"

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Award

Sep 28th 2006
From The Economist print edition

Vijay Vaitheeswaran, one of our business correspondents, has won the International Association of Energy Economics award for excellence in written journalism.

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About sponsorship

Theoretical physics

Looping the loop

Sep 28th 2006
From The Economist print edition

A new “theory of everything” is gaining ground

PHYSICISTS like everything neat and tidy. They assume that the universe must be governed by a single set of rules and are thus disturbed that, at the moment, they have to rely on two sets. One, called quantum mechanics, describes the small, fundamental particles of which matter consists and the forces by which those particles interact. The other, called general relativity, describes the force of gravity, which holds big objects together.

Reconciling these two universal descriptions has exercised some of physics' most brilliant minds, but has yet to provide an uncontested result. Until recently, the widespread expectation was that some version of an idea called string theory would prevail. But string theory has been around for decades without delivering the goods, and that failure has encouraged the protagonists of an alternative explanation to push themselves forward.

Getting knotted

Loop quantum gravity, as this rival is known, was dreamed up in 1986 by Abhay Ashtekar, of Pennsylvania State University. He rewrote the equations of general relativity to make them compatible with quantum mechanics. It really took off as an alternative to string theory, though, when it was picked up by Lee Smolin, now of the Perimeter Institute in Waterloo, Ontario, and Carlo Rovelli, of the Université de la Méditerranée in France. Together, they developed Dr Ashtekar's idea to show that it implies that space and time are not smooth, as general relativity requires, but come in tiny, distinct chunks.

This granularity emerges from what is the most important difference between the two theories. String theorists think that the world is made of matter that exists independently of space and time. The matter in question consists of particles that are formed from different vibrations of “strings”. (Strings are so called because they vibrate in a way that is similar, mathematically at least, to the vibrations of the strings of a musical instrument.) According to string theory, space and time are a fixed background that has a geometric structure—an unchanging stage on which nature's play takes place.

Loop quantum gravity is, in the jargon, background independent. This means that theorists working on it believe the laws of nature can be stated without making any prior assumptions about the geometry of space and time. Space and time are mere consequences of these laws. Loop quantum gravity can be visualised, as its name suggests, as a mesh of loops. According to its rules, it is meaningless to ask where in space and time this mesh exists, because the mesh is the stuff of which space and time are composed.

That is significant because it radically alters physicists' understanding of reality. Space is no longer the stage on which the pageant of existence is played out; it becomes part of the drama. Indeed, theorists working on loop quantum gravity think that matter itself is merely the result of twisting and braiding ribbons of space-time. A fundamental particle is created when three ribbons are joined in a plait. If one of the ribbons in the plait is twisted, it gives the resulting particle an electric charge. If it is twisted in the opposite direction, the particle has the opposite charge. And if it is twisted twice, the particle gains double the charge. So far, the theorists have described how three of the 16 particles in the Standard Model of particle physics may be created in this way.

String theory is the more established of the two; some 90% of theoretical physicists are engaged in developing it. But both it and loop quantum gravity harbour unresolved problems. Most important, neither has been tested experimentally. Nor, despite hopeful talk to the contrary, is there much prospect of an experiment being devised. While particle-physics colliders and space-based observatories could rule out some of the more exotic versions of each, no one has been able to suggest a way to decide between them in general.

Having two candidates for a theory of everything is almost as upsetting to physicists as their inability to reconcile quantum mechanics and general relativity in the first place. They would far rather have just one. This could be achieved by finding which one is right and which one is wrong, by finding that both string theory and loop quantum gravity are wrong and a third theory is right, or by finding that the two theories can be unified. Unfortunately, 20 years down the line, exactly how this may be done remains elusive.

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Particle physics

The light fantastic

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From The Economist print edition

A way of building particle accelerators on a table top

HIGH-ENERGY particle physicists like to smash things together, break them open and see what is inside. It is a good way of working out what the world is really made of, but it has its limits. The faster you hurl things, the more you find out. But the apparatus needed to hurl things fast enough to interest today's physicists is huge and horrifyingly expensive. The Large Hadron Collider (LHC), now being built near Geneva in a tunnel 27km (17 miles) in circumference, is expected to have cost SFr10 billion ($8 billion) by the time it opens next year.

In their heart of hearts, many particle physicists fear that the LHC will be the last big accelerator built. Their subject, intellectually important though it undoubtedly is, has little practical application. It may therefore become too expensive for taxpayers to sustain. However, a paper just published in *Nature Physics* by Wim Leemans of the Lawrence Berkeley National Laboratory in California and Simon Hooker of Oxford University may offer the subject a way out. For Dr Leemans and Dr Hooker describe a device that might cut costs drastically.

Conventional accelerators use pulses of electrical energy to push sub-atomic particles (usually electrons or protons) to high speeds. The Leemans-Hooker device, by contrast, uses intense pulses of laser light. Unlike the LHC, which contains (if that is the right word) a vacuum and accelerates protons, it contains hydrogen and accelerates electrons.

The hydrogen is in a narrow tube running through a block of artificial sapphire. First, the hydrogen is ionised by an electrical discharge. This not only separates the electrons and protons of which hydrogen atoms are composed, but also forces the resulting mixture, known as a plasma, towards the walls of the tube. That creates a channel through the plasma in the middle of the tube, and it is along this channel that the laser is fired.

The passage of the laser beam knocks electrons out of the plasma remaining in the channel, because electrons are light. But protons, which are much heavier, are left behind. The result, since protons are positive, is that the laser pulse is followed along the channel by a pulse of positive charge, which in turn attracts electrons (which are negatively charged and therefore attracted to positive charges). Those electrons are thus accelerated rapidly.

Other groups, it must be said, have tried this trick in the past. But they have not been as successful. The distinguishing feature of the Leemans-Hooker accelerator is the way that it stops the laser's light from dispersing, and so keeps its intensity high enough for it to carry on knocking electrons out of its path. This happens because the researchers have been able to manipulate the density of the plasma to make the tube act like one strand of a fibre-optic cable: the different densities serve to reflect stray light back into the channel in the middle, and the pulse stays in one piece.

Zap!

The Leemans-Hooker apparatus, which is a mere 3.3cm long, is able to accelerate electrons to a point where they have a fiftieth of the energy of those accelerated by the nearby Stanford Linear Accelerator (SLAC), an electron-accelerator 3.2km long. Unfortunately, building a desktop accelerator as powerful as SLAC is not just a matter of making a block of sapphire with a metre-and-a-half long hole through it (which is actually easier than it sounds). This is because the electrons out-run the positive pulse after only a few centimetres. Increasing their energy will therefore involve feeding them through a series of small accelerators, and that, in turn, will require exquisite timing so that each transition matches the new

laser pulse to the arrival of the electrons from the previous stage of the relay race.

Nevertheless, Dr Leemans and Dr Hooker are hopeful. They are already trying to boost the energy of their electrons by a factor of ten. If they succeed, their method will start looking very serious indeed. If it can be boosted by a factor of 100 or 1,000 it might even rescue particle physics from the clutches of the accountants.

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Microbiology

Long division

Sep 28th 2006
From The Economist print edition

Some bacteria are born old

LIFE is about choices. And one of those choices, in evolutionary terms, is about how long to live. Multicellular organisms, such as humans, are a compromise between the small number of cells that carry genes into the next generation (eggs and sperm) and the vast number that do not (all the others). For life to continue, it is essential that eggs and sperm are able to fulfil their destiny. That means keeping the rest of the body in good shape. But because organisms have limited resources, they must balance the demands of bodily repair and reproduction. The resulting compromise maximises reproduction over a lifetime at the expense of the body's gradual deterioration. Muscles weaken. Bones grow fragile. Skin creases. Nerve cells degenerate. And eventually the whole lot collapses.

Biologists call this explanation of ageing the disposable soma theory, soma being the Greek word for “body”. Until recently, it was assumed that the theory did not apply to unicellular organisms such as bacteria, since they have no soma to dispose of, merely a single cell that creates the next generation by dividing in two. But recent discoveries have suggested that bacteria, too, face compromises between maintaining themselves and reproducing. A paper just published in the *Proceedings of the National Academy of Sciences*, by Milind Watve and his colleagues at Abasaheb Garware College, in Pune, India, has examined what is going on.

Under a microscope, bacteria appear to reproduce by dividing exactly down the middle. Instead of growing, giving rise to offspring and fading away to death, the mother cell actually becomes its two daughter cells. The assumption was that these daughters are as close to identical as random variation permits, and that neither is subject to the sort of ageing imposed by the disposable soma theory. But that assumption depended on another: that the components of the mother cell are dealt out equally to the two daughters. Examination of bacterial division using modern techniques has shown that this is not always so. Sometimes one daughter gets preferential treatment, by receiving newly synthesised components instead of old, battered and repaired ones. The more aged a bacterium's innards are, the more mortal it appears. It is slower to metabolise and likelier to die before it has reproduced.

Dr Watve asked himself why this should be, and constructed a theoretical world inside a computer to investigate the matter. In this world, a bacterium can “choose” a mortal strategy, dumping all its old components into one daughter with limited prospects, and betting most of its future—and all of its new bits—on the other. Alternatively, it can divide itself symmetrically. The latter choice brings, if not eternal youth, then an equal pressure to avoid ageing, since neither daughter is more prone to death than the mother had been. But these daughters grow more slowly than the favoured daughters of unequal divisions, because their resources have to be divided between maintenance and reproduction.

When Dr Watve ran the model, he discovered that the main determinant of whether symmetrical or asymmetrical division was favoured was the amount of food around. In impoverished environments (in the real world, that might include lakes and oceans), the slower-growing daughters of symmetrical divisions had the upper hand because they used what little resources were available more efficiently. That was because the runts tended to die before they could reproduce, thus wasting the food that they had already eaten. In richer places, fewer runts died, and the daughters with shiny, new bits grew and divided very rapidly indeed. And that fits with the finding that bacteria inside the nutrient-rich human gut grow rapidly and in an asymmetrical manner.

Cosseted laboratory bacteria also divide asymmetrically, again in conformity with the theory. The question is whether those in poorer environments will prove more egalitarian. And the answer? No one has yet looked.

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The Allen brain atlas

Network navigator

Sep 28th 2006
From The Economist print edition

Neuroscientists now have an atlas of which genes are active in the brain

MENTION the words “billionaire” and “Microsoft” in the same sentence, and the mind turns naturally to the name William Henry Gates III. But Bill Gates's original accomplice, Paul Allen, is not short of a dollar, either. Like Mr Gates, Mr Allen has devoted part of his fortune to charity. But whereas Mr Gates's billions are combating various diseases that plague poor countries, Mr Allen's cash has been focused on a single project. The full title of his organisation is the Allen Institute for Brain Science, and the project—just completed—is an atlas of the brain.

The brain is the most complex organ in the body. Indeed, it could be argued that it is the most complex object in the known universe, and it is only recently that tools sophisticated enough to examine it in detail have been developed. The Allen Institute has used one of these tools, known as in-situ hybridisation, to look at the activity in the brain of almost every gene in the genome. The result is available to all at www.brain-map.org.

When a gene is active it produces messenger molecules that tell cells what to do. In-situ hybridisation works by detecting these messengers using molecules that bind specifically to each. These, in turn, are tagged with dye molecules that show up purple under a microscope.

Since human brains are hard to come by in large numbers, and almost impossible to obtain fresh and whole, the institute's scientists, led by Allan Jones, used mouse brains instead. That is obviously a compromise, but at this early stage in research, it is not a huge one. The mouse and human genomes are similar, and although mouse brains are smaller than human ones and have a different shape, the basic anatomy is the same. Dr Jones and his team therefore bred an enormous number of mice, killed them, sliced up their brains into thin layers, and “developed” each layer with a solution containing molecular tags for the messenger from one particular gene. Cells in which the pertinent gene was active turned purple, and each slice was then photographed.

The atlas itself was constructed by reassembling the photographs into three-dimensional images of the activity pattern of each gene. And the result held some surprises. The first surprise was that about 80% of the 21,000 genes in the mouse genome are active in the brain. That was more than had been expected, although it is not yet clear how many of that 80% are brain-specific.

The second surprise was that any gene which is active in the brain at all tends to be active everywhere. The assumption had been that because different bits of the brain do different things, they would show different activity patterns. That they do not will disappoint pharmaceutical companies who hoped that drugs might be tailored to hit particular parts of the brain by concentrating on genes that are active in those parts only.

On the other hand, the ability of the brain atlas to look at individual cells allows particular types of nerve cell to be recognised by their gene-activity patterns. The project has identified several hundred types of nerve cell this way, so it may be possible to tailor drugs to particular cell types, if not to particular brain regions.

Whether that will prove useful remains to be seen. But what the brain atlas seems to be showing is that different areas of the brain use the same parts list—just as different computers use the same sorts of electronic components. What matters is the way the parts are wired together. Discovering that circuit diagram is a job for the next brain atlas.

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Jazz

Before, and after, the birth of the cool

Sep 28th 2006
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Getty Images

The story of the record label that nourished John Coltrane and Miles Davis, two of the greatest exponents of modern jazz

ASK any fan or critic to nominate the most influential jazz figures of the past 50 years and two names will invariably come up: John Coltrane, saxophonist extraordinary, and Miles Davis, trumpeter. Linked artistically during their lives, their diverse but seminal contributions have come to attention once again by virtue of two anniversaries: Coltrane was born on September 23rd 80 years ago, and Davis died exactly 15 years ago.

Davis came to stardom first. Also born in 1926, in his teens he took part in recordings that proclaimed the arrival of the radically modern style of bebop. Only a few years later he pioneered a cooler alternative, reflecting his trademark trumpet sound—dark and spare, with a compelling lyricism. Though his career was briefly blighted by drug addiction, he returned to form in 1955 with a remarkable quintet, which for the first time included Coltrane.

Until then, the saxophonist had been regarded as little more than a journeyman, talented but unreliable, in thrall to booze and drugs. Davis, however, was willing to take a chance, and the two developed the potent partnership manifest in a handsome new box set of their best recordings. “The Miles Davis Quintet/The Legendary Prestige Quintet Sessions” (Prestige) portrays two different but complementary personalities. Davis's laconic, pointed attack was a perfect foil to Coltrane's intense, stream-of-consciousness flights, and both were propelled by one of the hardest-swinging of all jazz rhythm sections. Fans were bowled over by the band's high-voltage effect, though some critics found Coltrane too prolix. Davis himself, a man of few words and strong views, once asked the saxophonist why he played such long solos. When Coltrane said he just did not know how to stop, his leader replied, “Try taking the horn out of your mouth.”

Coltrane was a man on a mission. During his time with Davis, he confronted and defeated his addictive demons, a victory he attributed to “a spiritual awakening” that prompted a lifelong commitment “to play

The House that Trane Built: The Story of Impulse Records
By Ashley Kahn

Norton; 338 pages; $29.95.
Granta; £20

Buy it at
Amazon.com
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music that would make people happy". Not just make them happy, in fact, but elevate them to another plane. For Coltrane, music became more than mere entertainment. It was also the means by which he pursued an ecstatic personal quest, every time he played.

His spiritual hunger was matched by exhaustive practice. He sometimes literally fell asleep with his horn in his hands, and his knowledge of harmony, scales and modes was encyclopedic. The result, with the legendary quartet he assembled in 1960, was a series of volcanic masterpieces, which seemed to take jazz into altogether new territory. "Chasin' the Trane", from a session recorded live at the Village Vanguard in New York, was a torrential, visceral solo that lasted more than 15 minutes. On the "Ascension" album, a large ensemble expressed the same unbridled passion, producing what an awed critic called "possibly the most powerful human sound ever recorded".

All those records, and more of the same, were made for Impulse, which was Coltrane's home label until his death from cancer in 1967. In fact, as the title of Ashley Kahn's history of the company puts it, Impulse was "The House that Trane Built". Recognising its star artist as the epitome of the revolutionary, heaven-storming 1960s, Impulse was happy to give Coltrane carte blanche to record whatever he liked.

Mr Kahn offers a fascinating insider's view of the sessions that produced not only Coltrane's classics but also top-grade albums by both fiery radicals and such timeless stars as Duke Ellington, Coleman Hawkins and Benny Carter. And the delights of the music they made can be found on a twinned four-CD compilation, "The House that Trane Built: The Story of Impulse Records" (Impulse).

Coltrane's legacy survives not only in his music but, unusually, as a church, a form he would have appreciated. In 1972 a San Francisco congregation established the St John Coltrane African Orthodox Church, basing its liturgy on his music and his example.

By that time Davis had begun his transformation from jazz immortal to cultural icon. Finding himself sidelined by the rise of rock, in 1969 he responded by creating an electronic hybrid, jazz-rock fusion. His old fans were appalled, but Davis was defiant, and his pop-inflected music and image struck an adulatory chord with a whole new generation.

The trumpeter's edgy glamour became as significant as his music, setting teen crowds a-shrieking. It is fitting that, earlier this year, he became the first modern jazz musician ever elected to the Rock and Roll Hall of Fame. Mining the same vein, an anniversary compilation of his recordings, "The Very Best of Miles Davis: Cool and Collected" (Columbia/Legacy), contains wonderful music from his days with Coltrane and other giants, as well as later pop-chart covers. Clearly, throughout his career, Davis retained his great talent, however he chose to use it, just as he never forgot his old partnership. Even in his glam-rock days, as he shuttled between palatial residences, one totem the trumpeter always kept with him was a photograph of John Coltrane.

The House that Trane Built: The Story of Impulse Records.
By Ashley Kahn.
Norton; 338 pages; $29.95.
Granta; £20

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About sponsorship

Talleyrand

As with whist, so with politics

Sep 28th 2006
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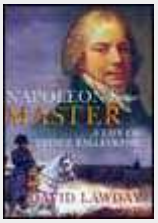
LAME from birth, yet with a talent for landing on his feet, Charles Maurice de Talleyrand-Périgord was for cartoonists a natural. As statesman and diplomat, he was at or never far from the centre of power through every upheaval that shook France—and Europe—between the fall of the Bastille and the collapse of the restored Bourbon monarchy in 1830.

The "prince with six heads", as one caricature nicely pictured him, was a bishop in the *ancien régime*, revolutionist in 1789, diplomat for Napoleon, minister to Louis XVIII and lastly—by which time he was already in his late 70s—ambassador in London for Louis Philippe, the "citizen king". Such frequent shifts inevitably won him many enemies. But with each turn of the carousel, former foes would become friends again. Talleyrand rose late, dressed slowly and played a lot of whist. He took a similar approach to politics, using time and delay to advantage.

To his detractors, Talleyrand was a corrupt and immoral opportunist of exaggerated reputation interested mainly in his family name. When in 1815 the writer and politician François René de Chateaubriand, his harshest scourge, glimpsed him limping along beside Napoleon's former police chief, he called the couple "vice supported on the arm of crime".

Napoleon's Master: A Life of Prince Talleyrand
By David Lawday



To be published in America by Thomas Dunne in autumn 2007.
Jonathan Cape; 386 pages; £20

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Talleyrand's name, to admirers, was a byword for diplomatic prowess: a brilliant political mind, a negotiator of unsurpassed skill and a tireless worker for the interests of France—not to overlook a fount of worldly *bons mots*. He probably never said that treason was a matter of dates, and "*Surtout, messieurs, point de zèle*" ("Above all, gentlemen, no zeal") is only shakily attributed. But he did say that Chateaubriand, in old age, thought he was going deaf only because he could no longer hear anyone talking about him.

Theories bored Talleyrand. But he was not, as some of his critics claimed, empty or cynical. He had a view of what was good for France and what was good for Europe, to which he stuck through revolution, war and restoration. An admirer, like many 18th-century Frenchmen, of British institutions, he believed in constitutional monarchy, individual liberties and a free press, although democracy was beyond his horizon. He thought trade essential to prosperity and wanted friendship between Austria, Britain and France to balance the power of Prussia and Russia. As the envoy of a defeated power at the Congress of Vienna, he played a weak hand with determination and skill, securing France within its pre-revolutionary borders and achieving a part at least of his vision for Europe.

The most recent life of Talleyrand in English was by Duff Cooper, a Conservative politician and diplomat, which was published in 1932. Now, in a style for today's times, David Lawday returns to the man behind the legend. A former member of *The Economist*'s staff, who has lived in France for many years and knows it well, he is an ideal biographer of Talleyrand. He admires his subject, though not uncritically. "Napoleon's Master" dwells particularly on Talleyrand's struggle, as a man of peace, to restrain a genius of war. But it is alive also with the world of the Paris salon and the glittering connections of a most sociable diplomat.

Napoleon's Master: A Life of Prince Talleyrand.
By David Lawday.
Jonathan Cape; 386 pages; £20
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Travel writing

Long and winding road

Sep 28th 2006
From The Economist print edition

“SHADOW of the Silk Road” is the culmination of Colin Thubron's long love affair with the great land mass that makes up Russia and Asia, a love affair that began in 1983 with “Among the Russians” and continued with “Behind the Wall: A Journey through China” (1987), “The Lost Heart of Asia” (1994) and “In Siberia” (1999). It is hard to imagine that this writer has it in him to write yet another book about the region. And yet he has.

Shadow of the Silk Road
By Colin Thubron

Chatto & Windus; 363 pages; £20

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Mr Thubron spent eight months travelling the 11,300 kilometres (7,000 miles) of the old Silk Road from Xian in the heart of China to Antioch (Antakya) in Turkey and, although he scrupulously admits in a note that his trip was broken by fighting in northern Afghanistan and that he was obliged to continue the following year, this interruption does not disrupt the flow of his narrative.

The spectre of the scare in China caused by an outbreak of SARS, severe acute respiratory syndrome, casts a menacing shadow over the first half of the book, which adds to the general impression of poverty and gloom. At one point, the author writes, “The desolation is palpable, of a land once watered, softer, now close to wilderness. Villages that once sustained themselves have shrunk inside their bleached walls, their people ageing, half their doors and windows bricked up.”

There is a perceptible change in mood as he leaves China. Mr Thubron admits that he is glad to be speaking Russian again. In Kyrgyzstan he met Nazira: “robust in baggy jacket and trousers. A wool hat was pulled close over her wind-flayed cheeks, and her hair sprouted in two black side-tufts bound with blue ribbons.” She had a spare yurt for the night and offered to make him supper.

Mr Thubron has a gift for talking to people, particularly women, who often come across as more content with their lives than the men he encounters, who always seem to want something that they have not got. Nazira rides her horses in the summer. “In winter she loved the sudden whiteness, which could pile up a metre high, closing her in.”

“Shadow of the Silk Road” is an astonishing achievement—both the journey and the book. Mr Thubron's tenacity, endurance, stamina and erudition metamorphose into exquisite prose. This is harder to achieve than one might think and can only be the result of huge effort and skill.

Shadow of the Silk Road.
By Colin Thubron.
Chatto & Windus; 363 pages; £20

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English poetry

They had been friends in youth

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ADAM SISMAN'S most recent book was a skilful account of a literary friendship between Dr Johnson, the great 18th-century raconteur, essayist, dictionary-maker and poet, and his faithful amanuensis and biographer, James Boswell. Now Mr Sisman has turned to the relationship between two of England's best-known Romantic poets, William Wordsworth and Samuel Taylor Coleridge.

The Friendship: Wordsworth and Coleridge
By Adam Sisman

To be published in America by Viking in February 2007.
HarperPress; 480 pages; £20

Buy it at
Amazon.com
Amazon.co.uk

Dr Johnson was one of the great sages of the Enlightenment. Wordsworth and Coleridge were in the vanguard of Romanticism, the movement that exalted personal feeling above the rule of reason.

The story of their friendship begins in the 1790s, against a backdrop of the French revolution. Both men were zealous political radicals in their youth and disappointed ex-radicals in their maturer years. They had other things in common. They were much the same age. Both had been orphaned early on in life; both studied at Cambridge University, with disappointing results; both were furiously committed to the importance of poetry; and both benefited from legacies, which gave them the time and space in which to dream.

In other respects they were very different. Coleridge was a brilliant and prodigious talker, Wordsworth inclined towards the taciturn. Coleridge spilled words onto pages like a stream in spate, Wordsworth detested writing; his sister Dorothy used to transcribe his poems and letters from his dictation. Wordsworth was disciplined, self-important and steady. Coleridge was a wastrel who spent his time devising unrealisable schemes. Hugely gifted, he was also scatterbrained, unreliable and, at the end, addicted to laudanum. He frittered himself away.

The two idealists came together as young men, and for a time were inseparable. They lived close together, in the Quantock hills in Somerset and also in the Lake District. They met, often daily. They worked at the same desk. They exchanged ideas and wrote poems together. They seemed to be sharing the same trajectory. In each other's company they “wantoned on wild poesy”.

For a short time their friendship helped each to write some of the greatest poems in English. One would aid and encourage the other, without any sense of rivalry or jealousy. But it could not last.

The difficulty lay in Coleridge's attitude towards his friend. To Coleridge, Wordsworth was a kind of god. He almost genuflected in his presence. As the years passed that devotion changed into envy, jealousy, misunderstanding and eventually embittered rupture. Coleridge meanwhile would often behave like a crazed being in a Gothic melodrama.

Coleridge had believed that his slightly older friend—they were separated by two years—was capable of writing a great philosophical poem that would change the world. It was Coleridge who had conceived the idea of such a work, a great epic that would reconcile man with nature. And while Wordsworth was busy with this epic, Coleridge would be writing formidable philosophical works, in which all human knowledge would be synthesised.

Feeling both guilty and somewhat badgered by Coleridge, Wordsworth never wrote that great poem, but he wrote others. Coleridge, for his part, never produced his philosophical synthesis, but amid all the chaos of his life he wrote enough, in prose and verse, to win a place in the pantheon of English literature.

It would be easy to exaggerate the personal elements in the story of the rise and fall of the friendship

between the two writers. But the historical background also plays a part, and it is complicated. Mr Sisman does not neglect it. Accumulating the evidence bit by bit, he makes the reader vividly aware of the events unfolding at the time. But in the end, argues Mr Sisman, the friendship was central: it was Wordsworth's rejection of him that was Coleridge's undoing.

The Friendship: Wordsworth and Coleridge.
By Adam Sisman.
HarperPress; 480 pages; £20.
To be published in America by Viking in February 2007

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New fiction

Worked to death in Denmark

Sep 28th 2006
From The Economist print edition

PLENTY of books promise to change their readers' lives. Few succeed. Christian Jungersen's “The Exception” is truly an exception. Read it and you will never look at your work colleagues in quite the same way again.

In this highly original psychological thriller set in the Centre for Genocide Information in Copenhagen, tidy pot-plants and orderly filing cabinets belie the seething mass of resentments, betrayals, back-stabbing and bullying among the female staff. Two researchers, Iben and Malene, are supposedly best friends. Camilla, a secretary, and Anne-Lise, a librarian, remain outside the charmed circle. Malene, though half-crippled by arthritis, is gorgeous and has a handsome boyfriend. She keeps an admirer, longed for by Iben, in reserve lest she is dumped.

Camilla and Anne-Lise have tormented pasts. E-mails arrive, threatening Iben and Malene with death. The first suspect is a Serb war criminal, Mirko Zigic, who committed hideous atrocities during the Bosnian war and is an obvious culprit. Perhaps too obvious.

Mr Jungersen steadily cranks up the tension: Anne-Lise is showered in dried blood, a boyfriend dies in a horrible accident which was, if not murder, clearly intentional negligence. The women begin turning on each other. Alliances form and dissolve like the patterns in a kaleidoscope, and a history of friendship is no guarantee of support. Perhaps quite the opposite.

Mr Jungersen's book has been sold in 14 countries and won the Danish equivalent of the Man Booker prize. Although it may be too long, the plaudits are deserved. Mr Jungersen is good on the bizarre international “genocide industry” with its swish seminars, showpiece survivors and squabbling professors. His brisk style, well rendered in Anna Paterson's fine translation, generally keeps the story moving along.

The book's fascination lies in the way the women react under pressure: one thrives, wielding a gun like the killers she documents, another collapses, while a third performs an act of extraordinary self-sacrifice. Herein lies its message. “The Exception” subtly suggests that, however deeply buried, there may, if provoked, be a killer in everyone.

The Exception.
By Christian Jungersen. Translated by Anna Paterson.
Weidenfeld and Nicolson; 487 pages; £12.99.
To be published in America by Nan A. Talese in July 2007

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Buy it at
Amazon.com
Amazon.co.uk

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About sponsorship

American football

The search for supermen

Sep 28th 2006
From The Economist print edition

And, amid all the meticulous mayhem, the deep significance of the agile monster

EPA

Verbal skills optional

The Blind Side: Evolution of a Game
By Michael Lewis

Norton; 288 pages; $24.95.
To be published in Britain by Norton in November

Buy it at
Amazon.com
Amazon.co.uk

BOOKS on baseball crowd the shelves of American libraries. In contrast, little has been written about American football. The explanation lies largely in the very different ways in which the two sports lend themselves to a descriptive narrative. In baseball, the action can be followed from the time the pitcher grabs the ball until the batter is either called out or scores. So clear is the story line that the audience for baseball and its often poetic writing may exceed the audience for baseball-watching.

The game of football, though, simply explodes. From the moment the ball is passed backwards through the legs of the centre to the quarterback, 22 players are in constant motion trying to execute complex instructions, each intimately involved in the way the play will be resolved. No writing can really capture such intricacy; it must be seen. Throughout the autumn and into winter, millions of fans give up their weekends to watch young men tear each other to bits in a game that is a blend of mayhem and meticulous planning.

In “The Blind Side”, Michael Lewis provides a compelling book by explaining how this subtle and brutal game has changed as the balance of power has shifted between talented athletes and clever, devoted coaches. Traditionally, the most valuable players were those adept at handling the ball, and none was more valuable than the quarterback, the player who receives the ball first. After watching any number of these stars pounded into the turf by increasingly adept defensive players, coaches came to a new conclusion—that a quarterback may not be worth much at all without superior protection. Thus began the search for, in a sense, physical contradictions: monsters whose sheer bulk could plug the gap at Thermopylae but whose agility would allow them to dance through a field of broken bodies. It is the task of these men to protect the quarterback from being crushed by players coming up on the side of his non-throwing hand—his blind side—where he is most vulnerable.

A book that was only about the shifting priorities in football strategy would be of limited interest, but the heart of Mr Lewis's story tells the story of one of the first beneficiaries of this hunger for a new superman. Michael Oher came from American society's own blind side. He was born to a crack-addicted mother with an ability to produce children whom she could not bring up—13 of them—and an absent

father. Lost to the conventional world of childhood, he reached high school without knowing how to read, calculate or, to a large degree, even speak.

Mr Oher had not, however, been an indifferent student. He had merely applied himself with singular dedication to another subject, basketball. As a result of his application and innate talent, he became agile and quick. And he did inherit some genetic gifts: over time, he not only grew tall, he swelled into a child giant, with huge thighs and powerful shoulders that could fill a doorway or, more to the point, protect a quarterback. It took just a single chance meeting, a glance really, by an ambitious football coach at a private Christian school in Memphis to change his life. In Mr Oher this coach, as well as others, saw the potential to transform their teams into winners in a world where nothing is more important. That Mr Oher had never played football when he had first been spotted, and would have only limited experience when it was time to be recruited for college, was of little concern. Mr Oher had unusual gifts, and, as Mr Lewis shows, they would produce unusual rewards.

In short order Mr Oher would gain a new loving family, determined teachers and, perhaps, a brilliant future. It is a remarkable story along the lines of Horatio Alger's, the anyone-can-do-it fable often considered the classic American tale.

Mr Lewis specialises in finding unlikely heroes, who benefit from, or drive, a major shift. Success came first with his books about men he believed changed America's economy and maybe its society, too: bond traders (“Liar's Poker”) and an internet entrepreneur (“The New New Thing”). He then took this approach of using individuals to capture a trend in money and society by looking at baseball (notably “Moneyball”). If there was a flaw in these amusing books, it was that, in retrospect, they oversold their claims. His heroes were more heroic, and more significant, on the page than in life. Mr Oher, now starting his second year as a player of college football, must be hoping for a better fate.

The Blind Side: Evolution of a Game.
By Michael Lewis.
Norton; 288 pages; $24.95.
To be published in Britain by Norton in November

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About sponsorship

Ann Richards

Sep 28th 2006
From The Economist print edition

Corbis

Ann Richards, governor of Texas, died on September 13th, aged 73

NOT much about Texas is becoming or demure. The coast is muddy and malarial; the west, seen from the air, is an immense brown mat of desert; the centre is scrubland munched by cattle. The state's history is one long tale of men imposing their wills on this landscape; and, much more rarely, of big-haired weather-beaten women imposing their wills on the men.

That was always easier said than done. Texan men, like their livestock, cluster companionably in the shade. Oilmen groom the politicians; politicians do their best for the oilmen. Corporations grease the legislators; legislators return the favour. In their dark haunts, principally the clubs and bars of Austin, women for many years were welcome only as a decorative adjunct on the arm of some good ol' boy with a dropping cigar and a bolo tie.

Ann Richards could do decorative, if required. Her official garb, over 18 years in Texas politics, was a “Dallas”-style creation of big white hair, pearls and sharp-shouldered suits in shocking blue. She could copy the boys if it made them feel good, smoking (she had rolled her own as a girl, out of cedar-bark), shooting, fishing, riding Harleys, telling dirty stories and, until she bravely embraced sobriety in 1980, knocking back martinis with the best of them. But her favourite reaction to the cosy male universe she found herself in was to put on a pink plastic pig-snout, call herself “Harry Porko” and make fun of them. It was strange, she would say, but true, that men were frightened of funny women.

Even the Bushes, the premier Republican dynasty of Texas, ran scared of her for a time. Though they posed as Texans, she knew they were Connecticut *parvenus* who preferred to summer in Maine. They were nothing like herself, a country girl whose parents came from Bugtussle and Hogjaw, who remembered the menfolk playing dominoes on summer nights, and whose voice made one of her speechwriters think of barbed wire and mesquite covering the Waco hills.

Her best joke, told in that twang at the Democratic National Convention in 1988, commiserated with “Poor George” senior, “born with a silver foot in his mouth”. Mr Bush laughed gamely, sending her a silver-foot pin which she wore whenever he, as president, returned to Texas. (“A woman always wears the jewellery when the man who gave it to her comes to visit.”) But Barbara Bush seethed about “that woman”, and young George plotted, and got, eventual revenge.

By the time he did, ousting her from the governor's mansion in 1994, Mrs Richards had made a fair

amount of difference to her state. Over eight years as treasurer she had modernised cash management, shifting it from punch-card computers to electronic transfer, and earning an extra $1.7 billion a year in interest on investments. As governor, from 1990, she tried to clean up and open out the state commissions and agencies, starting proper audits and performance reviews and appointing more women and minorities than all the governors before her put together. And lest this was dismissed as typical woman's stuff, she also oversaw the biggest prison-building programme in American history.

The last Democrat

Some things she never tried to change. What would she do, she was asked once, if the legislature repealed the death penalty? “I would faint,” she replied. Texas schools remained glaringly unequal, despite a court order to share funds more evenly. Oil revenues were stagnant, but Mrs Richards knew better than even to mention a state personal income tax. Though Texas increasingly looked like a broad, bragging California, full of high-tech clusters and with the white Anglo culture besieged by Latinos and Asians, Mrs Richards was well aware of the unchanging lower layers. She lost in 1994, in part, because she opposed allowing Texans to carry concealed weapons. But then, as she said, what woman in Texas could possibly find a handgun among the clutter in her bag?

She was an anomaly as governor, the only woman ever to hold the post in her own right. Indeed, she might never have got there if her Republican opponent, Clayton Williams, had not compared rape to bad weather (“you might as well relax and enjoy it”), and if women had not turned out in crowds to vote for her. And she was also an anomaly as a Democrat. Towering Democratic figures—Sam Rayburn, Lyndon Johnson—had sprung out of Texas in the past. But nothing about the place made it natural turf for the party from the 1980s onwards. The Republican ascendancy was unstoppable. After 1994, no Democrat won statewide office again.

Turned out of power by “some jerk”, young George, Mrs Richards did not go far. She stayed in Austin, lobbying and thoroughly enjoying the place, until oesophageal cancer shadowed the picture. For her, in middle age, politics had been liberation: from housewifery, from suburban life, from the endless train of laundry and perfectly frosted cakes. It meant fun, with the serious undertow of showing what Texan women could do. Her ghost may still haunt the governor's mansion, plumping up the pillows in the bedroom where Sam Houston slept, admiring from the window the one vaguely liberal city in Texas, and remarking with only a touch of bitterness, “Don't those boys make me look good?”

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Overview

Sep 28th 2006
From The Economist print edition

The **oil price** dropped briefly below $60 a barrel for the first time since March. Since early August it has declined by 21% because of growing worries about a global slowdown next year.

After years in which the American consumer has buoyed global demand, much concern is focused on the outlook for **housing in the United States**. There were further signs this week that the market is cooling fast. The median house price fell by 1.7% in the year to August, according to the National Association of Realtors—the first annual decline since April 1995. Activity was also much lower than a year ago. Sales of existing homes fell by 12.6% in the year to August while those of new homes declined by 17.4%.

On a brighter note, the fall in the price of oil appears to be pepping up **American consumer confidence**, which increased from 100.2 in August to 104.5 in September, according to the Conference Board. However, orders for manufactured durable goods fell for the second month running in August, declining by 0.5%.

Businessmen in **Germany** are holding their nerve. The Ifo business-climate index barely dipped in September, confounding expectations of a sharper decline. However, **French** businessmen have become a bit gloomier. The INSEE index, which tracks their mood, fell from 108 in July to 107 in September.

The immediate industrial outlook in the **euro area** is still looking good. New orders rose by 1.8% in July, more than expected. That left them 9.7% higher than a year before, thanks to higher demand for machinery and transport equipment.

Britain's economy grew more slowly in the second quarter, compared with the first, than had previously been reckoned. Official statisticians revised growth down from 0.8% to 0.7%. However, they left growth in the year to the second quarter unchanged at 2.6%. They made a sharp downward revision to growth in nominal GDP during the same period, lowering it from 6.0% to 4.8%. The current-account deficit narrowed to £7 billion ($12.8 billion) in the second quarter, from £8.7 billion in the first three months of the year.

In **Japan**, the price index for services traded among companies rose by 0.3% in the year to August, the first annual increase for more than eight years.

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Output, demand and jobs

Sep 28th 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 1.9	Q2	+ 1.3	+ 3.2	+ 3.3	– 1.0	Q1	+ 3.6	Q2	4.9	Aug	5.0
Austria	+ 3.0	Q2	+ 3.6	+ 2.4	+ 1.9	+ 7.9	Jul	+ 2.2	Jul	4.8	Aug	5.3
Belgium	+ 2.8	Q2	+ 3.1	+ 2.6	+ 1.9	+ 3.7	Jul	– 1.6	Jun	13.0	Jul†	13.4
Britain	+ 2.6	Q2	+ 2.8	+ 2.6	+ 2.5	– 0.5	Jul	+ 4.3	Aug	5.5	Jul‡	4.7
Canada	+ 2.9	Q2	+ 2.0	+ 3.1	+ 2.8	+ 0.4	Jun	+ 5.5	Jun	6.5	Aug	6.8
Denmark	+ 2.4	Q2	+ 7.8	+ 2.7	+ 2.3	+ 5.6	Jul	+ 3.4	Jul	4.4	Jul	5.8
France	+ 2.6	Q2	+ 4.9	+ 2.2	+ 2.0	+ 1.3	Jul	+ 5.5	Jul	8.9	Jul	9.9
Germany	+ 2.4	Q2	+ 3.6	+ 2.0	+ 1.3	+ 4.7	Jul	nil	Jul	10.6	Sep§	11.7
Italy	+ 1.5	Q2	+ 1.9	+ 1.5	+ 1.2	– 0.2	Jul	– 0.3	Jun	7.0	Q2	7.8
Japan	+ 2.5	Q2	+ 1.0	+ 2.8	+ 2.3	+ 5.1	Jul	– 1.0	Jul	4.1	Jul	4.4
Netherlands	+ 2.8	Q2	+ 4.8	+ 2.5	+ 2.2	+ 1.9	Jun	+ 4.6	Jun	5.4	Aug††	6.6
Spain	+ 3.7	Q2	+ 3.6	+ 3.3	+ 2.8	+ 5.0	Jul	+ 1.1	Jul	7.6	Jul	8.5
Sweden	+ 5.1	Q2	+ 5.4	+ 4.1	+ 2.9	+ 1.5	Jul	+ 8.0	Aug	5.7	Aug†	6.5
Switzerland	+ 3.2	Q2	+ 3.0	+ 3.0	+ 1.9	+ 4.3	Q4	+ 2.1	Jul	3.1	Aug†	3.6
United States	+ 3.6	Q2	+ 2.9	+ 3.4	+ 2.5	+ 4.7	Aug	+ 2.5	Jul	4.7	Aug	4.9
Euro area	+ 2.4	Q2	+ 3.6	+ 2.3	+ 1.8	+ 3.2	Jul	+ 2.5	Jul	7.8	Jul	8.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 6.6	Q2	+ 7.6	na	na	+12.5	Jul	+ 5.1	Jul	7.8	Aug	8.2
Greece	+ 4.1	Q2	na	na	na	+ 1.4	Jul	+10.1	Jun	9.7	Q1	10.4
Iceland	+ 2.8	Q2	na	na	na	na		na		1.4	Jul†	2.0
Ireland	+ 5.8	Q1	+ 4.4	na	na	+ 8.4	Jul	+ 5.5	Jul	4.4	Aug	4.4
Luxembourg	+ 7.3	Q1	na	na	na	– 2.7	Jun	– 4.8	Jun	4.1	Jul	4.0
New Zealand	+ 2.1	Q1	+ 2.3	na	na	– 0.7	Q1	+ 0.9	Q2	3.6	Q2	3.7
Norway	– 0.5	Q2	+ 1.9	na	na	– 2.9	Jul	+ 5.0	Aug	3.2	Jul**	4.7
Portugal	+ 0.9	Q2	+ 3.8	na	na	+ 1.3	Jul	+ 4.7	Jul	7.3	Q2†	7.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡May-Jul; claimant count rate 3.0% in Aug.
§EU harmonised rate 8.2% in Jul. ††Jun-Aug. **May-Jul.

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Prices and wages

Sep 28th 2006
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2006	The Economist poll consumer prices forecast 2007	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 4.0	Q2	+ 2.5	+ 3.2	+ 2.7	+ 9.9	Q2	+ 6.9	+ 4.7	Q2	+ 5.8
Austria	+ 1.8	Aug	+ 2.0	+ 1.9	+ 1.8	+ 3.9	Aug	+ 0.9	+ 2.7	Aug	+ 2.3
Belgium	+ 1.6	Aug	+ 3.1	+ 2.1	+ 1.9	+ 6.3	Jul	+ 1.9	+ 2.1	Jul	+ 2.5
Britain	+ 2.5	Aug*	+ 2.4	+ 2.2	+ 2.1	+ 2.6	Aug	+ 3.0	+ 4.4	Jul†	+ 4.1
Canada	+ 2.1	Aug	+ 2.6	+ 2.3	+ 2.1	+ 4.3	Jul	– 0.3	– 0.4	Jun	+ 1.6
Denmark	+ 2.0	Aug	+ 2.2	+ 2.0	+ 2.0	+ 4.3	Aug	+ 5.0	+ 3.2	Q2	+ 2.9
France	+ 1.9	Aug	+ 1.8	+ 2.0	+ 1.7	+ 3.9	Jun	+ 2.9	+ 3.1	Q2	+ 3.0
Germany	+ 1.0	Sep	+ 2.5	+ 1.8	+ 2.3	+ 5.3	Aug	+ 1.9	– 0.5	Jul	+ 1.3
Italy	+ 2.2	Aug	+ 2.0	+ 2.2	+ 1.9	+ 6.9	Jul	+ 3.6	+ 3.0	Jul	+ 2.8
Japan	+ 0.3	Jul	– 0.3	+ 0.4	+ 0.8	+ 3.4	Aug	+ 1.8	– 0.3	Jul	+ 2.5
Netherlands	+ 1.4	Aug	+ 1.8	+ 1.5	+ 1.6	+ 5.3	Jul	+ 5.3	+ 1.9	Aug	+ 0.8
Spain	+ 3.7	Aug	+ 3.3	+ 3.7	+ 3.0	+ 5.7	Aug	+ 4.9	+ 3.1	Q2	+ 3.4
Sweden	+ 1.6	Aug	+ 0.6	+ 1.5	+ 1.9	+ 3.9	Aug	+ 4.2	+ 3.8	Jun	+ 3.0
Switzerland	+ 1.4	Aug	+ 1.0	+ 1.3	+ 1.4	+ 3.1	Aug	+ 1.0	+ 1.0	2005	+ 0.9
United States	+ 3.8	Aug	+ 3.6	+ 3.5	+ 2.6	+ 3.7	Aug	+ 5.3	+ 3.9	Aug	+ 2.7
Euro area	+ 2.3	Aug	+ 2.2	+ 2.2	+ 2.1	+ 5.9	Jul	+ 4.1	+ 2.4	Q2	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.9	Aug	+ 1.0	na	na	+ 6.3	Aug	+ 3.8	+ 2.9	Q2	+ 3.7
Greece	+ 3.5	Aug	+ 3.7	na	na	+ 7.2	Jul	+ 5.1	na		na
Iceland	+ 7.6	Sep	+ 4.8	na	na	+11.4	Sep	+ 4.6	+10.6	Aug	+ 6.7
Ireland	+ 4.5	Aug	+ 2.3	na	na	+ 0.9	Aug	– 1.1	+ 2.2	Q1	+ 6.4
Luxembourg	+ 2.8	Aug	+ 2.7	na	na	+10.4	Jul	+ 5.5	+ 0.7	Jun	+ 2.0
New Zealand	+ 4.0	Q2	+ 2.8	na	na	+ 7.8	Q2	+ 4.7	+ 3.3	Q2	+ 2.6
Norway	+ 1.9	Aug	+ 1.9	na	na	+ 8.8	Aug	+19.9	+ 3.6	Q2	+ 3.8
Portugal	+ 2.0	Aug	+ 2.6	na	na	+ 4.9	Aug	+ 4.4	– 1.5	Jul	– 2.1

*RPI inflation rate 3.4% in Aug. †May-Jul.

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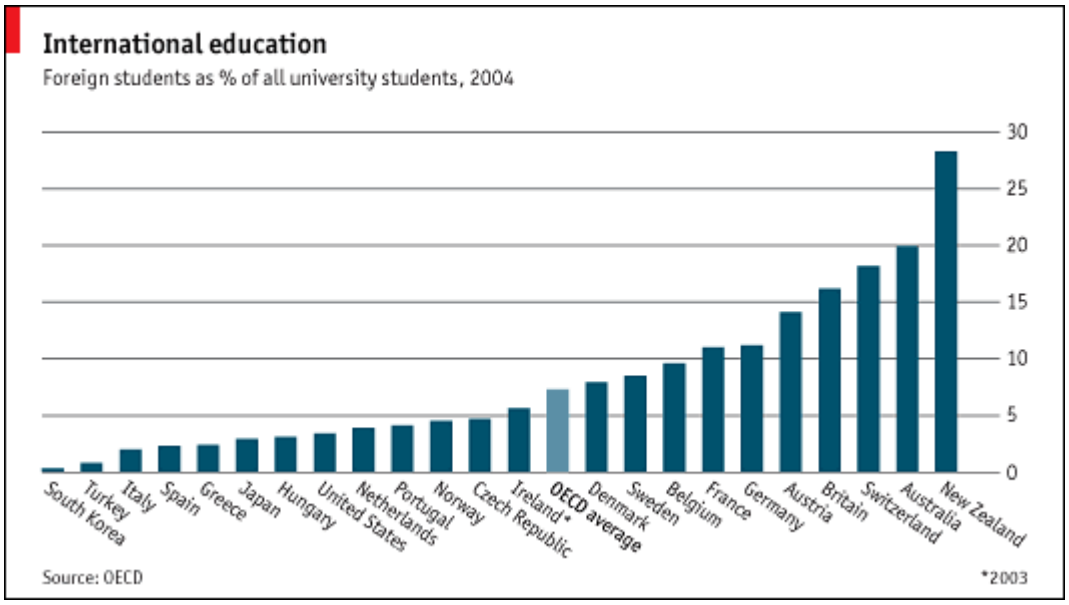
International education

Sep 28th 2006
From The Economist print edition

Maybe it is the lure of “The Lord of the Rings”, but New Zealand has vaulted in popularity among students who are as footloose as Frodo. Over a quarter of its university enrolments come from overseas. America has so many domestic students that it ranks much lower, even though it attracts 21.6% of the world's 2.7m foreign students. That, however, represents a sharp decline from its share of 25.3% in 2000.



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Money and interest rates

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From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Sep 27th 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 9.4	+10.4	Jul	6.21	5.65	5.82	5.49	5.38	6.72
Britain	+ 5.1	+13.7	Aug	5.02	4.56	4.88	4.46	4.26	5.55
Canada	+15.5	+ 6.5	Jul	4.16	2.86	3.94	3.97	3.94	5.28
Denmark	+10.3	+ 7.4	Jul	3.45	2.20	3.59	3.65	3.06	5.13
Japan	+ 2.3	+ 0.5	Aug	0.34	0.02	0.61	1.63	1.42	1.79
Sweden	+ 0.5	+11.0	Jul	2.55	1.46	3.29	3.58	2.99	3.73
Switzerland	- 1.3	+ 1.9	Aug	1.78	0.77	1.97	2.36	1.87	2.55
United States	- 0.6	+ 4.7	Aug	5.21	3.85	4.70	4.59	4.26	5.54
Euro area†	+ 7.4	+ 7.8	Jul	3.38	2.15	3.52	3.63	3.10	4.31

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.73%, Japan No. 282 1.65%. Central bank rates: US fed funds 5.25%, ECB refinancing 3.00%, BOJ overnight call 0.25%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Sep 28th 2006
From The Economist print edition

2000=100

	Sep 19th	Sep 26th*	% change on one month	% change on one year
Dollar index				
All items	170.6	172.2	+ 0.3	+ 30.4
Food	135.7	135.8	+ 2.2	+ 12.5
Industrials				
All	215.6	219.3	– 1.2	+ 49.5
Nfa†	139.5	135.3	– 8.1	+ 1.4
Metals	257.2	265.1	+ 0.9	+ 72.1
Sterling index				
All items	137.1	137.8	+ 0.2	+ 21.5
Euro index				
All items	124.2	125.6	+ 0.9	+ 23.5
Yen index				
All items	185.5	187.0	+ 0.4	+ 34.7
Gold				
$ per oz	579.15	591.70	– 4.8	+ 28.6
West Texas Intermediate				
$ per barrel	61.65	61.12	–12.4	– 6.0

*Provisional. †Non-food agriculturals.

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Stockmarkets

Sep 28th 2006
From The Economist print edition

Market indices

	Sep 27th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,055.0	5,318.2	4,708.8	+ 1.9	– 4.9	+ 7.4	+ 9.8
Austria (ATX)	3,813.0	4,344.4	3,324.1	+ 2.4	– 12.2	+ 4.0	+12.0
Belgium (Bel 20)	4,062.4	4,062.4	3,445.1	+ 1.0	nil	+14.5	+23.3
Britain (FTSE 100)	5,930.1	6,132.7	5,506.8	+ 1.1	– 14.4	+ 5.5	+16.1
Canada (Toronto Composite)	11,751.6	12,487.3	10,904.3	+ 1.0	– 5.9	+ 4.3	+ 9.3
Denmark (OMXCB)	379.7	395.5	325.0	+ 2.0	– 4.0	+ 3.2	+11.2
France (SBF 250)	3,686.9	3,755.6	3,244.2	+ 1.0	– 16.0	+11.7	+20.3
France (CAC 40)	5,243.1	5,312.2	4,615.4	+ 1.0	– 24.3	+11.2	+19.8
Germany (DAX)*	5,989.7	6,140.7	5,292.1	+ 0.6	– 25.7	+10.8	+19.3
Italy (S&P/MIB)	38,329.0	38,765.0	34,850.0	+ 0.6	– 23.5	+ 7.4	+15.7
Japan (Nikkei 225)	15,947.9	17,563.4	14,218.6	+ 1.5	– 59.0	– 1.0	– 0.5
Japan (Topix)	1,591.0	1,783.7	1,458.3	+ 1.3	– 44.8	– 3.6	– 3.0
Netherlands (AEX)	481.9	481.9	412.9	+ 1.1	– 31.3	+10.3	+18.9
Spain (Madrid SE)	1,409.2	1,409.2	1,156.8	+ 4.2	nil	+21.9	+31.3
Sweden (Affarsvarlden Gen)	325.6	333.7	275.2	+ 0.1	– 18.6	+11.0	+21.0
Switzerland (Swiss Market)	8,413.1	8,413.1	7,154.9	+ 0.8	nil	+10.9	+17.5
United States (DJIA)	11,689.2	11,689.2	10,667.4	+ 0.7	– 0.3	+ 9.1	+ 9.1
United States (S&P 500)	1,336.6	1,336.6	1,223.7	+ 0.9	– 12.5	+ 7.1	+ 7.1
United States (NASDAQ Comp)	2,263.4	2,370.9	2,020.4	+ 0.5	– 55.2	+ 2.6	+ 2.6
Europe (FTSEurofirst 300)†	1,397.1	1,405.6	1,238.7	+ 1.2	– 18.1	+ 9.5	+18.0
Euro area (FTSE Euro 100)†	1,198.7	1,198.7	1,050.0	+ 1.3	– 22.7	+10.1	+18.6
World (MSCI)‡	1,373.8	1,406.3	1,243.9	+ 1.1	– 5.2	+ 9.2	+ 9.2
World bond market (Citigroup)††	650.2	653.7	612.1	+ 0.6	– 2.5	+ 4.8	+ 4.8

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Sep 28th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Sep 27th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Sep 27th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2006‡
Australia	− 11.4	Jul	− 41.0	Q2	− 5.7	− 5.3	116.7	118.3	1.33	1.32	2.52	1.69	1.14	+ 0.9
Austria	− 1.3	Jun	+ 6.4	Q1	+ 0.5	+ 0.4	105.7§	104.8	0.79	0.83	1.49	–	0.67	− 1.9
Belgium	+ 15.7	Jul	+ 7.3	Mar	+ 1.5	+ 1.6	107.6§	106.5	0.79	0.83	1.49	–	0.67	− 0.4
Britain	−140.1	Jul	− 64.4	Q2	− 2.7	− 2.7	102.3	98.7	0.53	0.57	–	0.67	0.45	− 3.4
Canada	+ 58.8	Jul	+ 28.6	Q2	+ 2.3	+ 1.5	129.4	122.7	1.11	1.18	2.10	1.42	0.95	+ 2.2
Denmark	+ 8.2	Jul	+ 5.9	Jul	+ 2.0	+ 1.8	106.5	105.7	5.87	6.21	11.1	7.46	5.00	+ 3.3
France	− 33.2	Jul	− 36.3	Jul	− 1.7	− 1.4	108.4§	107.1	0.79	0.83	1.49	–	0.67	− 2.9
Germany	+185.8	Jul	+106.2	Jul	+ 3.6	+ 3.6	110.1§	108.5	0.79	0.83	1.49	–	0.67	− 3.1
Italy	− 23.9	Jul	− 34.3	Jul	− 1.7	− 1.5	108.0§	106.8	0.79	0.83	1.49	–	0.67	− 4.2
Japan	+ 78.0	Jul	+165.1	Jul	+ 3.6	+ 3.5	79.9	84.8	117	113	222	149	–	− 5.2
Netherlands	+ 39.0	Jul	+ 46.2	Q2	+ 6.0	+ 5.9	108.5§	107.2	0.79	0.83	1.49	–	0.67	− 0.5
Spain	−103.2	Jun	− 92.6	Jun	− 8.0	− 7.7	105.9§	105.1	0.79	0.83	1.49	–	0.67	+ 1.1
Sweden	+ 19.7	Aug	+ 24.1	Q2	+ 6.7	+ 6.0	97.8	95.3	7.30	7.82	13.8	9.28	6.22	+ 1.7
Switzerland	+ 8.2	Aug	+ 51.7	Q1	+12.7	+12.1	105.4	106.0	1.24	1.30	2.35	1.58	1.06	− 0.2
United States	−839.7	Jul	−838.1	Q2	− 6.7	− 6.7	83.7	86.2	–	–	1.89	1.27	0.85	− 3.6
Euro area	− 20.9	Jul	− 52.3	Jul	− 0.4	− 0.2	118.6	115.4	0.79	0.83	1.49	–	0.67	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 10.9	Jul	+ 11.8	Jul	na	na	109.2§	108.0	0.79	0.83	1.49	–	0.67	+ 2.2
Greece	− 39.2	Jun	− 25.1	Jul	na	na	105.0§	104.1	0.79	0.83	1.49	–	0.67	− 3.0
Iceland	− 2.0	Jul	− 3.4	Q2	na	na	85.6**	100.9	70.1	63.2	132	89.1	59.7	+ 2.0
Ireland	+ 38.1	Jul	− 5.6	Q1	na	na	113.9§	111.9	0.79	0.83	1.49	–	0.67	− 0.3
Luxembourg	− 5.1	Jun	+ 3.9	Q1	na	na	107.6§	106.5	0.79	0.83	1.49	–	0.67	− 1.7
New Zealand	− 4.4	Aug	− 10.2	Q2	na	na	129.1	135.4	1.51	1.46	2.85	1.92	1.29	+ 4.6
Norway	+ 59.8	Aug	+ 56.5	Q2	na	na	106.4	111.5	6.52	6.52	12.3	8.29	5.56	+ 18.5
Portugal	− 22.2	Jun	− 16.7	Jul	na	na	105.9**	105.0	0.79	0.83	1.49	–	0.67	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, July average. ‡OECD forecast. **IMF, June average.

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Current-account balances

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From The Economist print edition

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Overview

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From The Economist print edition

In **South Africa**, consumer-price inflation accelerated to 5.4% in the year to August. In **Hong Kong**, it picked up to 2.5% over the same period, the highest rate for almost eight years.

Brazil's current-account surplus widened to $13.8 billion in the 12 months to August. Over the same period, **Argentina's** trade surplus narrowed to $11.3 billion because of surging imports.

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Competitiveness

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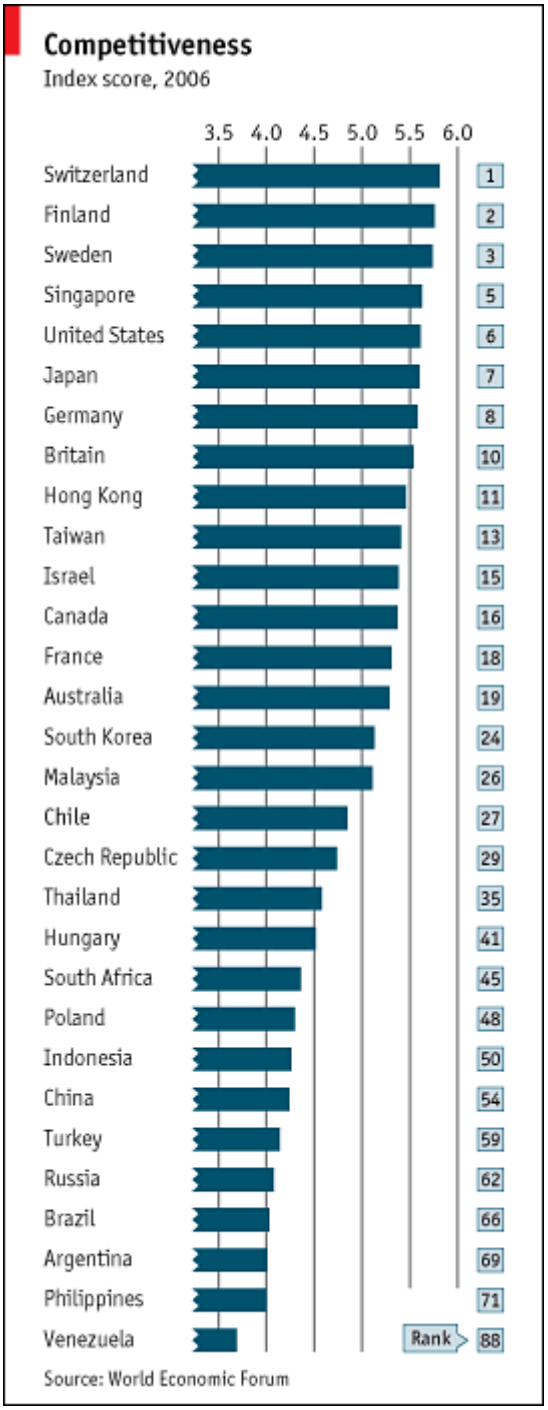
From The Economist print edition

High taxes and generous welfare safety nets need not undermine competitiveness, according to the World Economic Forum's latest ratings. Scandinavian economies are ranked high in the league owing to budget surpluses and effective health and education systems. Switzerland comes top, while America has dropped from first to sixth place, partly because of its growing trade and current-account deficits.



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Economy

Sep 28th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.3	Q2	+15.7	Aug	+ 1.3	Aug	+135.9	Aug	+160.8	2005	941.1	Jun
Hong Kong	+ 5.2	Q2	+ 5.3	Q2	+ 2.5	Aug	−14.9	Aug	+18.6	Q2	128.9	Aug
India	+ 9.3	Q1	+12.4	Jul	+ 6.7	Jul	−41.8	Aug	−10.6	Q1	158.0	Aug
Indonesia	+ 5.2	Q2	+ 1.0	Jun	+14.9	Aug	+34.7	Jul	+ 3.8	Q1	40.4	Aug
Malaysia	+ 5.9	Q2	+ 7.3	Jul	+ 3.3	Aug	+28.0	Jul	+19.5	Q1	78.8	Jul
Pakistan	+ 6.6	2006†	+14.3	Jun§	+ 8.9	Aug	−12.5	Jul	− 5.0	Q2	11.6	Jun
Philippines	+ 5.5	Q2	−10.4	Jul	+ 6.3	Aug	− 4.1	Jul	+ 2.9	Mar	18.6	Aug
Singapore	+ 8.1	Q2	+ 5.5	Aug	+ 0.7	Aug	+32.6	Aug	+38.3	Q2	130.7	Aug
South Korea	+ 5.3	Q2	+10.6	Aug	+ 2.9	Aug	+16.0	Aug	+ 5.8	Aug	227.0	Aug
Taiwan	+ 4.6	Q2	+ 4.8	Aug	− 0.6	Aug	+19.4	Aug	+20.6	Q2	261.0	Aug
Thailand	+ 4.9	Q2	+ 6.1	Jul	+ 3.8	Aug	− 2.3	Jul	+ 2.8	Jul	57.1	Jul
Argentina	+ 7.9	Q2	+ 7.6	Aug	+10.7	Aug	+11.3	Aug	+ 7.4	Q2	25.1	Jul
Brazil	+ 1.2	Q2	+ 3.2	Jul	+ 3.8	Aug	+46.1	Aug	+13.8	Aug	68.8	Aug
Chile	+ 4.5	Q2	+ 1.9	Jul	+ 3.8	Aug	+18.5	Aug	+ 2.2	Q2	16.3	Aug
Colombia	+ 6.0	Q2	+13.6	Jul	+ 4.7	Aug	+ 0.8	Jun	− 2.0	Q1	14.9	Aug
Mexico	+ 4.7	Q2	+ 5.8	Jul	+ 3.5	Aug	− 4.2	Aug	− 0.6	Q2	83.0	Jul
Peru	+ 9.0	Jul	+ 5.6	Jul	+ 1.9	Aug	+ 6.9	Jul	+ 1.3	Q2	14.3	Aug
Venezuela	+ 9.2	Q2	+14.3	Jun	+14.9	Aug	+37.2	Q2	+29.5	Q2	23.8	Jun
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 8.9	Aug	−11.2	Q1	+ 2.1	Q1	23.2	Aug
Israel	+ 6.2	Q2	+13.4	Jul	+ 2.2	Aug	− 7.9	Aug	+ 5.8	Q2	28.1	Aug
Saudi Arabia	+ 6.6	2005‡	na		+ 2.1	Jun	+126.5	2005	+90.7	2005	22.8	Jul
South Africa	+ 3.6	Q2	+ 5.8	Jul	+ 5.4	Aug	− 7.9	Jul	−13.3	Q2	21.9	Aug
Czech Republic	+ 6.2	Q2	+11.8	Jul	+ 3.1	Aug	+ 1.6	Jul	− 3.8	Q2	30.7	Aug
Hungary	+ 3.8	Q2	+12.2	Jul	+ 3.5	Aug	− 3.3	Jul	− 7.9	Q1	20.8	Aug
Poland	+ 5.5	Q2	+12.5	Aug	+ 1.6	Aug	− 3.2	Jul	− 4.9	Jul	46.7	Aug
Russia	+ 7.4	Q2	+ 5.6	Aug	+ 9.7	Aug	+139.6	Jul	+91.4	Q2	252.2	Aug
Turkey	+ 7.5	Q2	+ 9.5	Jul	+10.3	Aug	−50.1	Jul	−29.6	Jul	57.0	Jul
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+12.0	Q2	+ 7.6	Jul	+ 5.0	Aug	− 2.7	Jun	− 1.8	Jul	2.2	Jul
Latvia	+10.9	Q2	+ 3.9	Jul	+ 6.8	Aug	− 3.9	Jul	− 2.8	Jul	3.4	Jul
Lithuania	+ 7.7	Q2	na		+ 4.2	Aug	− 4.2	Jul	− 2.2	Jun	4.2	Jul
Slovakia	+ 6.2	Q2	+ 8.3	Jul	+ 5.1	Aug	− 3.0	Jul	− 4.6	May	12.4	Jul
Slovenia	+ 4.9	Q2	+ 7.1	Jul	+ 3.2	Aug	− 1.8	Jul	− 0.6	Jul	8.1	Jun

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate. §New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Sep 28th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Sep 27th		Dec 30th 2005	
	Sep 27th	year ago	Sep 27th	% a year		one week	in local currency	in $ terms
China	7.90	8.09	14.9	2.95	1,812.3	– 0.5	+ 48.4	+ 51.6
Hong Kong	7.79	7.76	14.7	4.20	17,521.5	nil	+ 17.8	+ 17.2
India	45.9	44.0	86.7	6.50	12,366.9	+ 2.1	+ 31.6	+ 29.1
Indonesia	9,210	10,375	17,390	11.52	1,523.1	+ 3.0	+ 31.0	+ 40.0
Malaysia	3.68	3.77	6.95	3.85	966.3	+ 0.7	+ 7.4	+ 10.2
Pakistan	60.6	59.7	114	10.06	10,387.1	+ 3.5	+ 8.7	+ 7.2
Philippines	50.2	56.1	94.8	7.63	2,556.7	+ 1.7	+ 22.0	+ 28.9
Singapore	1.59	1.69	3.00	3.44	2,557.9	+ 1.0	+ 9.0	+ 14.1
South Korea	944	1,038	1,782	4.63	1,360.0	– 0.5	– 1.4	+ 5.6
Taiwan	33.0	33.3	62.2	1.81	6,946.3	+ 1.0	+ 6.1	+ 5.7
Thailand	37.5	41.2	70.8	5.40	693.0	– 1.4	– 2.9	+ 6.1
Argentina	3.10	2.91	5.86	10.38	1,644.7	– 1.0	+ 6.6	+ 3.9
Brazil	2.19	2.25	4.13	14.17	36,105.0	+ 2.6	+ 7.9	+ 15.2
Chile	537	539	1,014	5.16	10,641.6	+ 1.4	+ 15.6	+ 10.2
Colombia	2,403	2,294	4,537	6.53	9,121.9	– 0.7	– 4.1	– 8.7
Mexico	11.0	10.9	20.8	7.05	21,748.6	– 0.4	+ 22.2	+ 18.0
Peru	3.25	3.32	6.13	4.50	10,343.8	+ 2.5	+115.4	+127.5
Venezuela	2,755§	2,651§	5,202	10.00	34,926.7	– 0.4	+ 71.3	+ 60.7
Egypt	5.74	5.76	10.84	9.33	56,987.5	+ 0.7	+ 2.9	+ 2.9
Israel	4.30	4.58	8.12	5.65	837.2	+ 0.2	+ 1.1	+ 8.2
Saudi Arabia	3.75	3.75	7.08	5.25	11,157.2	+ 0.4	– 33.2	– 33.2
South Africa	7.65	6.43	14.5	8.45	22,249.7	+ 2.9	+ 23.0	+ 1.9
Czech Republic	22.3	24.6	42.2	2.60	1,448.7	+ 0.3	– 1.6	+ 8.4
Hungary	215	207	406	7.99	22,190.1	+ 0.2	+ 6.8	+ 6.2
Poland	3.13	3.26	5.91	4.20	43,995.9	– 0.4	+ 23.6	+ 28.6
Russia	26.8	28.5	50.5	11.50	1,519.1‡	– 2.3	+ 25.7	+ 35.0
Turkey	1.50	1.35	2.83	20.32	36,818.7	– 3.8	– 7.4	– 16.6
EM (MSCI)*	1.00	1.00	1.89	na	776.0	– 0.2	+ 9.8	+ 9.8
EMBI+†	1.00	1.00	1.89	na	391.2	+ 0.4	+ 6.1	+ 6.1

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Trading market value.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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